INDUSTRIAL FINANCE IN INDIA

A STUDY IN INVESTMENT BANKING AND STATE-AID TO INDUSTRY WITH SPECIAL REFERENCE TO INDIA

BY

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PREFACE

The present study is an attempt at a survey and solution of the main problems of industrial finance in India. The principal agencies for the supply of industrial finance in the country have been analysed and the part played by each of these factors in the provision of industrial finance has been carefully examined. Among these factors the managing agents have played so important a part and have aroused so much public interest that it has been necessary to examine in some detail the various forms in which they have rendered this financial assistance to industry. With the passage of the State-Aid to Industries Acts in the various provinces of India, the State is taking an increasing interest in the financing of Indian industries. The extent and form of the financial assistance furnished by the State to industry have been investigated and in this connection an analysis of the working of the State-Aid to Industries Acts has been attempted. A review of the recent activities of the State elsewhere with regard to industrial financing has also been made, as forming a useful and interesting background for our Indian study.

The question of the relationship of banks to industry has occupied the centre of the stage in recent discussions of the problem of industrial financing here as well as abroad; and it has, therefore, been worthwhile to consider in some detail the question of banking policy with regard to industrial financing in some representative countries. The question of establishing special institutions for solving the problem of long-term industrial finance which has been receiving considerable attention in recent years has been carefully investigated. A review of the structure, organisation and activities of these specialist institutions in various countries has been attempted. Finally, the lines on which a suitable machinery for solving the problem of long-term industrial finance in India may be evolved have been suggested.

The background of the study has been gleaned entirely from original and authoritative sources. Published material on most of the subjects dealt with is limited, fragmentary and even non-existent. Personal investigations have always been made and materials have been collected from various countries of the world. The writer has depended upon State documents and official reports, personal letters, questionnaires and interviews for most of the information presented here. He is indebted to Governments, Chambers of Commerce, banking institutions, industrial companies and businessmen in many countries for furnishing him with most valuable materials, replying to questionnaires and otherwise assisting him in his research enquiries.

The entire information regarding the Industrial Bank of Japan and the Industrial Mortgage Banks of Europe has been obtained from the respective countries in which the Institutions function. The writer's grateful thanks are due to Mr. Gustav Fogelholm, Managing Director of the Industrial Mortgage Bank of Finland, for furnishing him with its Articles of Association, Business Reports and Balance Sheets, as well as for replying to two detailed questionnaires. He is under obligation to the Royal Hungarian Consul in India and the authorities of the National Hungarian Industrial Mortgage Institute; to Mr. E. Banasinki, Consul for Poland, and the authorities of the National Economic Bank of Poland; to the Consul for Germany in India and the authorities of the Provincial Mortgage Bank of Saxony; to His Britannic Majesty's Consul in Tokyo, Mr. Hara, Consul for Japan in India, and the authorities of the Industrial Bank of Japan for furnishing him with all the official documents, Articles of Association, Business Reports, Statutes, etc., of the respective Institutions. The materials are not available in India and have been obtained directly from the different countries in which the Banks operate. In some cases the literature was not available in the English language and translations had to be made. The writer is very grateful to

Dr. Benoy Kumar Sarkar of the Calcutta University for assisting him in translating all the documents relating to the Saxon Mortgage Bank from original German into English and to Mr. Hara for translating some documents relating to the Japanese Industrial Bank from original Japanese into English.

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For information relating to the working of the Managing Agency System in India the author is particularly indebted to the Hon. Mr. Nalini Ranjan Sarker, Minister of Finance, Government of Bengal; the Hon. Mr. S. D. Gladstone, President of the Bengal Chamber of Commerce; and Mr. A. C. Daniel, Secretary of the Bengal Chamber of Commerce. The Hon. Mr. N. R. Sarker's assistance has been really invaluable. It would never have been possible for the writer to approach the Bengal Chamber of Commerce and the European firms of Managing Agents affiliated to it without his help. It is at his special request that Mr. A. C. Daniel, Secretary of the Chamber, very

kindly introduced the writer to the Heads of a number of European Managing Agency firms, requesting them to assist him in his research enquiries by furnishing him with information and documents regarding the origin, working and organisation of the Managing Agency System in Calcutta. Messrs. Gillanders Arbuthnot and Co., Messrs. Mcleod and Co., Messrs. Turner Morrison and Co., among other European firms, should be particularly mentioned for their kind and courteous assistance. Thanks are also due to Mr. Manu Subedar, author of the Minority Report of the Indian Central Banking Enquiry Committee, Mr. K. C. Mahindra of Messrs. Martin and Co., Mr. J. J. Kapadia, Secretary of the Bombay Shareholders' Association and Mr. J. B. Bartlett Richards, American Trade Commissioner in India, for valuable information and helpful suggestions. Thanks are also due to the Government of Bengal for their favour of special permission granted to the writer to study the Articles of Association, Managing Agency Agreements, Balance Sheets, Summaries of Capital and Lists of Shareholders of various industrial companies at the office of the Registrar, Joint-Stock Companies, Bengal.

Thanks should also be expressed to Mr. Bruce Gardner, a Director of the Bankers' Industrial Development Co., as well as of the Securities Management Trust (England), to the Managing Director of the Imperial Bank of India and to Messrs. Place, Siddons and Gough (Calcutta) for their kind courtesy in replying to the author's queries.

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The present work is based upon a thesis approved for the Degree of Doctor of Philosophy of the University of Calcutta in January, 1937. The Board of Examiners consisted of Sir Cecil Kisch, C.B., Prof. T. E. Gregory and Mr. P. B. Whale. In preparing it, the necessary materials had to be obtained from Europe, Australia, Canada and Japan. For various reasons its publication has been unavoidably delayed. It has been revised and brought up to date as far as possible under the present international situation.

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CHAPTER I

Introduction

A great deal of interest has been focussed on the question of industrial finance in recent years. The problem came to receive earnest attention for the first time immediately after the cessation of hostilities in 1918. The four years of the Great War, the most exhausting that history has ever known, shattered the economic order of Europe as no war had done before. An enormous economic wreckage had piled up during the War; factories, machineries, whole industries, that had taken years and years of effort to build up, had most wantonly been destroyed. Factories had to be rebuilt, machineries had to be replaced, old industries had to be rehabilitated and new ones had to be started. While a considerable amount of finance was required for this enormous task of reconstruction, most countries were faced with a shortage of industrial capital. The problem of providing adequate financial facilities for their industries assumed an importance it had done never before.

Besides industrial reconstruction, the question of increased post-war competition in the markets of the world was a further factor to be considered. It was apparent that immediately after the War was over, the belligerent countries would be making strenuous efforts to regain their lost trade and increase it, if possible. The development of export industries was, therefore, urgently called for to achieve the purpose. It was perceived even in England that she would have to take particularly quick steps to develop and reorganise her export industries, if she were to maintain her position in the overseas markets and to wrest

from her rivals, if possible, some of their growing trade in these directions. Complaints regarding the inadequacy of financial facilities for industries were hitherto unheard of in England. There was no reason yet to doubt the efficacy of the existing machinery for furnishing industrial credit in Great Britain. But the need of developing the export industries became so pressing that the question of financial facilities for industry came to be widely discussed there and even engaged the attention of the Government of the day. An important committee was appointed by the Board of Trade in 1916 "to consider the best means of meeting the needs of British firms after the War, as regards financial facilities for trade, particularly with reference to the financing of large overseas contracts."

In India also, the question of industrial finance began to receive prominent attention about that time. There had been growing, for some time past, a widespread feeling that the development of Indian industries was hopelessly inadequate. India had an enormous wealth and variety of raw materials but instead of utilising them in her own industries, she was merely exporting them to enrich the economic development of other countries. There was probably no other country where the resources were so immense, the possibilities so great and the achievements so meagre. India had a great industrial future and it was highly desirable that steps should immediately be taken to ensure a rapid industrialisation of the country. One of the first requisities of industrial development, it was pointed out, was an adequate supply of financial facilities and the financial needs of Indian industry must be fully satisfied in order to achieve the desired goal of industrial progress.

It was also felt that the capital needs of Indian industry would grow to a considerable extent as soon as the War was over. The tonic of the War must foster a large number of new industries. Old industries would require to be reconditioned and overhauled. Extensions would also be urgently called for in many instances so as to obtain the economies of large-scale

production. Industrial finance was required on a larger scale than ever before. An Industrial Commission which was appointed about this time gave great prominence, in their Report published in 1918, to this question of financial facilities for Indian industries and stressed for the first time the desirability of establishing specialist institutions for financing them.

In more recent years, in the thick of the world-wide economic storm, when industrial stagnation became acute and unemployment figures were mounting rapidly, the same question of industrial finance was resuscitated once more both in England and in India. Ideas were gaining ground that lack of adequate financial facilities had considerably intensified the present industrial depression, and a regular and systematic supply of such facilities was urgently required to bring about a quick industrial recovery. Re-organisation, reconditioning, modernisation of plant and machinery—in some cases very badly needed—could never be effected without this financial assistance. The banking system in this connection came in for some very sharp criticisms in England as well as in India. There appeared to be an undercurrent of feeling that the banks were not doing their best to help the industries and the relations of banks to industry aroused the keenest of discussions in both the countries.

The controversy over this thorny question assumed such proportions in England that it was made, among other things, the subject matter of investigation by an important Committee under the Chairmanship of Lord Macmillan in 1929. In the same year the Government of India appointed a Banking Enquiry Committee as a concession to a great popular demand. Not only was the examination of the entire banking system of the country included in its purview but one of its main objects was stated to be an enquiry into the present position of industrial finance in India and also the part played by the Indian banks in its provision.

Broadly speaking, organised industry requires two kinds of finance, fixed or block capital and floating capital or short term accommodation for its day-to-day needs. The former includes

not only the long and large loans which are required for the inception of a new industry, for purchasing land, erecting factory buildings and installing plant and machinery, but also the more or less permanent funds which an old established concern needs to extend and reorganise itself, to remove old plant much of which may have become obsolete and refit with the best appliances and lastly to take prompt advantage of new processes and discoveries. The initial capital is generally raised by means of subscriptions from the investing public, while the capital for replacement or extension is usually raised by means of debenture issues, bearing a fixed rate of interest. The floating or working capital is required for the purchase of raw materials and stores, for expenses incidental to the marketing of products, for financing outstandings in respect of goods supplied and for providing the necessary funds for paying wages and meeting the day-to-day requirements. These credits are of a temporary or seasonal character, either self-liquidating or to be repaid ultimately out of the issue of more permanent capital. To furnish these short-dated credits which are endless in the variety of their conditions is the principal function of the bank.[1] A certain portion, however, of the working capital of an industry, although used for current expenses, is really of the nature of permanent capital. The stock of raw materials, manufactured and semi-manufactured commodities never falls below a certain minimum and the capital required for holding them is of the nature of permanent capital. Only that amount of working capital over and above this minimum can be characterised as short term finance. According to strict theory, therefore, a portion of the normal working capital must have to be provided out of the subscribed share capital and the industrial company must be working for some time before it is ready for financial accommodation from banks.[2] The nature of an industry has a great

[1] Report of the Committee on Finance and Industry, 1931, cmd. 3897, p. 160.

[2] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 146.

deal to do with the relative proportion between block and working capital required. The more roundabout and complex the processes of production grow, the greater must be the proportion of fixed to working capital. In such industries as hydro-electric, iron and steel and even in jute and cotton, block capital is very large in relation to working capital. On the other hand, in the case of the small and cottage industries where production is carried on under the simplest conditions and with most inexpensive tools and implements, the reverse is the case. In between the above two kinds of credits, long and short term, industries frequently require credits for intermediate periods, *i.e.*, for periods varying from one or two up to five years. As the Macmillan Committee have pointed out in their report, such intermediate credits fall mainly into three types, *viz.* (*i*) hire purchase or instalment sales, (*ii*) advances against deferred payment and (*iii*) long-term credits.[1]

In any comprehensive plan for providing industrial finance for a country, attention must no doubt be directed towards the provision of all the above three kinds of financial facilities—short, medium and long-term. But primary attention must be paid to the third form. The very life blood of industrial growth lies in the systematic and orderly supply of this long-term finance. The question of long-term industrial finance has assumed, for a variety of reasons, particular importance in India. It ran like a thread throughout the mass of evidence tendered before the Industrial Commission of 1916 and before the last Central and Provincial Banking Enquiry Committees. In these days of economic planning and industrial rationalisation, it has received an added importance. It has been frankly recognised that any programme for the industrial recovery of India must include within its purview a well-ordered scheme for providing long-term financial assistance to her industries. While the question of the provision of long-term industrial finance should engage our

1 *Report of the Committee on Finance and Industry*, cmd. 3897, pp. 169-70.

foremost attention, that of the supply of working capital to industry cannot also be neglected. The inadequacy of working capital for industry and the high cost of such as is available are an important element in the problem of industrial finance in India. In any study of industrial finance in India, a consideration of this aspect of the problem is also called for.

At the present moment when we are seeking to discover the most efficient methods of financing industries in India, a study of how the problem of industrial finance has been solved elsewhere may prove to be not only of absorbing interest but also of great value. Different countries have attempted to solve the problem in different ways and in this connection a survey may very usefully be undertaken of some of the typical methods adopted in financing industries. It will be necessary to analyse the principal agencies for industrial finance and to examine the part played by each of them in its provision. The question of special machineries for furnishing financial assistance to industries should be carefully investigated and the lines on which such a machinery, if necessary, may be evolved for India should also be suggested. It is in this background that a study of industrial finance may profitably be made in India.

CHAPTER II

BANKS IN RELATION TO INDUSTRIAL FINANCING—GERMAN BANKS AND INDUSTRY[1]

In any study of industrial finance, a great deal of attention must be paid to the relationship of banks to industry. Nothing has aroused so much interest and nothing has been made the subject-matter of so much controversy as this question of the relations of banks and industry. What should be the banking policy in relation to industrial financing? Should the banks furnish permanent capital to industry or should they confine themselves to the provision of current finance only? Are the banking facilities in either of these senses adequate for industry? These are some of the questions which have been widely discussed in recent years.

Banking policy with regard to industrial financing has not been uniform in every country. Broadly speaking, the attitude of banks has been either one of close collaboration with or of strict aloofness from industry. The former attitude of which Germany offers the best example is typical of all Continental banking, and is to be found chiefly in Italy, Austria, Hungary, Belgium and the Netherlands. The latter is characteristic of the English system of deposit banking. A discussion of the relations between banks and industry must necessarily call for a treatment of the important part played by the German banks in the financing of German industries. It has occupied the centre of the stage in all recent discussions of banking policy with regard to

1 The substance of this chapter was published in the form of an article in the *Calcutta Review*, September and October, 1931 (revised and re-written)

industrial financing. Repeated references were made to it by a large number of witnesses before the Committee on Finance and Industry in England as well as the Central Banking Enquiry Committee in India. In many quarters, however, there exists even to this day a great deal of misconception, at any rate in the popular mind, as regards the extent and form of the industrial finance provided by the banks in Germany. There is, for instance, a kind of impression that the industrialist in Germany gets from the banks advances for fixed capital purposes that he would not get from an English banker. There is a widespread idea that the German banker takes a peculiar delight in granting long-term credits. But Dr. Goldschmidt in the course of his evidence before the Macmillan Committee clearly stated that it was, generally speaking, not the case. The German banker believes as much as any other banker that, generally speaking, it is not the business of a bank to grant long-term credits. He has a great antipathy, in common with bankers all over the world, against advances for fixed capital purposes and always looks critically at any credit which is not a floating credit for working capital purposes.[1] "He only gives it in exceptional cases and after he has fully investigated the condition of the individual companies and has satisfied himself as to what purposes the credit will serve and what are the possibilities of amortisation." In many instances when the bankers have found it impossible to avoid the granting of such credits, they have had to help industry over difficult periods by taking up themselves shares and bonds as during the crisis of the inflation and stabilisation periods. But lasting participation has not generally been their policy with regard to industrial enterprises, at least in the modern times.[2] They may have been forced to this position when an issue has proved to be unsuccessful or when they have had to buy back their own issues to maintain their price. Thus, during the

1 *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 155.

2 P. B. Whale, *Jointstock Banking in Germany*, p. 46.

post-war years, the banks were often severely handicapped in their issue and placing business, so that they were unable to place more than a limited portion of their holdings and could reduce their security portfolios only temporarily.

Ideas are also widely current that German banks frequently start new industries and act as managers of industrial concerns as well. Generally speaking, the starting of new industries is not their function. When private enterprises are converted into jointstock companies, and if such conversion is warranted by the size, past records and prospects of the business, the banks sometimes take a limited share interest in the new companies. But any impression that the banks start with selling shares of the jointstock company, buying factory sites, bricks and steel and thus establish an enterprise is wholly wrong.[1] The banker never claims to be an industrialist in Germany. It is not his practice, ordinarily speaking, to act as a responsible leader or manager of industrial concerns. It is only when the financial structure of industrial companies shows so many cracks that they have become particularly weak or insecure that the banker in Germany steps in and assumes responsibility for management.[2] But it is involuntary and never sought for.

At the same time, however, it must be observed that just as it is wrong to think that the German banks are always ready to furnish long-term finance to industry or participate in the promotion of industrial companies, it will be equally wrong to believe that they have never done it. In his anxiety to dispel some of the prevalent illusions regarding the industrial activities of the German banks Dr. Jeidels caused considerable misapprehension in the minds of the members of the Indian Central Banking Enquiry Committee.[3] An impression seems to have been

[1] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV; p. 173.

[2] *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 149.

[3] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, pp. 171-79.

conveyed by his observations that the German banks had at no stage of their development furnished long-term finance or taken an active part in promoting industrial companies by taking up their shares. That impression is not correct. The truth is that the German banks have evolved themselves into a position to-day which is wholly different from that in the earlier stages of their development. Dr. Jeidels appears to have overstressed the recent trends only and ignored the activities of the German banks in the earlier stages of their development. He was undoubtedly speaking of the present position of German banking whereas his Indian colleagues in the Committee probably had at the back of their minds the activities of the banks in the earlier years. The evolution in the German banks has been going on through a long process of years and is probably still not complete. Three different stages are noticeable in this evolution; and their functions have undergone remarkable changes as they have passed from one phase of development to another. In order to understand the relationship of the German banks to industry in its true perspective, it will be necessary for us to go back to the beginnings of these institutions and to trace the alteration in their policy with regard to industrial financing through the successive phases of their evolution.

1848-1870 :—

In the first stage of their development the German banks were pre-eminently banks for loans to industry ; and as such played an important rôle in the financing of German industries. They were formed with a distinct industrial bias. Take for instance, the Schaafhausen'scher Bank verein of Cologne, the first German jointstock bank, established in 1848. Although the statute precluded it from indulging in any kind of speculative activity outside the sphere of proper banking business, the institution from the very start invested in shares of various companies, mortgages and industrial enterprises. Within a few years of its establishment, it financed several mining and

metallurgical undertakings in the Rhineland and Westphalia. The Bank fur Handel und Industrie was established in 1853 with the distinct object of taking an interest in industry. It was modelled on the "credit mobilier" of France and one of its co-founders, Abraham Oppenheim, was the founder of the Credit Mobilier. This bank was expressly empowered by its statute "to participate in the promotion of new companies, the amalgamation and consolidation of different companies and the transformation of industrial undertakings into jointstock form, and also to issue and take over for its account the shares and debentures of such newly created companies." [1] It contemplated from the very start promoting solid and large-scale undertakings through the investment of its own and outside funds. In the first year of its existence it was responsible for the development of German and foreign railways. It took over shares of the Austrian State Railway, purchased the entire Brunswick railway system and held preference shares in the Cologne Minden railway. It also influenced the growth of many engineering and textile industries in the South of Germany and took part in the flotation of many German and Austrian loans. A number of other banks was established about this time following the model of the Bank fur Handel und Industrie more or less closely. Of these the more important were the Disconto Gesselschaft, the Berliner Handels Gesselschaft and the Mitteldeutsche Creditbank. The Disconto was established in 1851 with a capital of 30 million marks and was changed into a limited liability company in 1856. Like the Bank for Industry and Trade at Darmstadt, it participated in numerous railway transactions. It became connected with the Silesian Railway Company, the Alsenez Railway, the Rhine Nahe Railway, etc. Besides railways, it was also engaged in the development of salt pits, mines and iron works as well as secondary banks and insurance companies.[2] It had even in recent years several industrial interests among which the well

1 Art. III K of Statute of the Bank fur Handel und Industrie.

2 Hauser, *Germany's Commercial Grip on the World.*

known United Steel Works and the Hamburg American line might be mentioned.

It is interesting to note that the German banks in this period carried on their business with their own capital resources and were not dependent upon deposits from the public. The balance sheets of 14 jointstock banks in 1857 showed a total of 296 million marks of which not less than 205 millions were represented by the money of the shareholders and only 57 millons by deposits and acceptances.[1] The ordinary banking business of receiving deposits and making short-term loans from these deposits was considered by them merely as a side-line. Their main business consisted in investing the shareholders' money in industrial and commercial enterprises, the object being to reap as large a profit as possible for the shareholders. A considerable portion of their resources was invested in industrial securities. The banks in that period, therefore, "partook more of the character of investment trust companies than of banks properly so called."[2]

1870-1913 :—

The banks assumed a new character when they began the systematic fostering of deposit business from the early nineties. The lead was taken by the Deutsche Bank ; and the other banks soon followed it in attracting deposits by offering more liberal terms and by making them in favour of the traders and manufacturers. The following figures strikingly bring out the enormous growth of bank deposits. The deposits (including current account balances) of all banks rose from 1932·18 million marks in 1889 to 9641·59 millions in 1913, of which 5148·63 millions were held by 9 Berlin banks.[3] The following figures given by

[1] *Banks and Industry in Germany*, an article by S. G. Feodossief, in the *Bankers'. Magazine*, June, 1930.

[2] *Ibid.*

[3] P. B. Whale, *Jointstock Banking in Germany*, p. 23.

Dr. Riesser also illustrate the growth of deposits in the case of the four 'D' banks between 1870 and 1908[1] :—

Bank.	Year.	Deposits (in million marks).
1. Deutsche	1871	8
	1908	489
2. Dresdner	1875	2·8
	1908	224·5
3. Disconto	1871	14·8
	1908	218·5
4. Darmstadter	1870	16·1
	1908	108·8

The resources of the banks, which in the earlier stage had been confined to their own capital and reserves, came now to consist of other people's money in the form of more or less short-term deposits. The rapid economic development of Germany during this period necessitated the provision of finance for the growing requirement of trade and manufacturing concerns. With the increase in the deposits, the banks became able to extend more credits to them. Thus a considerable part of the constantly growing volume of deposits came to be used by them for assisting the development of industries in which they were interested as promoters, shareholders and debenture-holders. The banks which had originally resembled investment trust companies and considered pure banking business as a mere side-line now gradually evolved themselves into deposit banks. But they did not abandon their old preference for investment banking: their original character of the investment trust companies was retained. They combined the investment trust business of the former period with the deposit business of this period; their business became mixed and varied. From this period they acquired their distinctive features and came to be known as

1 Riesser, *The Great German Banks and their Concentration*, pp. 205-08.

"mixed banks." In addition to the business of an English jointstock bank, it now included the functions which are regarded in England as belonging properly to company promoters, issue houses, underwriters, merchant bankers, discount houses and even stockbrokers.

1913-1930—War and Post-War Years :—

The evolution of the German banks did not, however, stop at that stage. They have been developing along new lines in more recent years. (Ever since the last Great War, a slow but steady revolution has been taking place in their business. During the war and the years immediately following it, lending to public authorities became the main business of the banks. They concentrated on financing Government by floating its loans. The Government in many cases took upon itself the task of financing industry. The opportunities for dealing in or for creation of securities were also limited by war time regulations. All these circumstances altered to a considerable extent the status of the German banks; they became during this period purely deposit banks.) The following figures giving the average percentage of securities to total assets in the case of eight Berlin banks during 1914-18 strikingly illustrate the marked decline that took place in their security holdings[1] :—

	1913	1914	1915	1916	1917	1918
Eight Berlin Banks ...	13·0	13·9	11·8	9·1	6·6	6·2

This decline in the percentage of securities to total assets was not only well maintained in the post-war years but was even accentuated in the years of the inflation. The banks grew more and more cautious. They became reluctant to tie up their funds for long periods and concentrated far more on regular banking business than formerly. There was no doubt a revival of the typical industrial activities of the German banks

[1] P. B. Whale, *Jointstock Banking in Germany*, p. 202.

during the years 1926 and 1927 but barring this, their tendency to "switch" over to deposit banking, and that in the English sense of the expression, was unmistakable. This recent trend in German jointstock banking is amply illustrated by the following figures showing a marked decline in the relative financial importance of their investment banking business. As compared with the figures for 1913, the decrease in the relative size of long-term investments as shown by the proportion of own securities and syndicate participations to total assets is strikingly significant[1] :—

	Securities as Percentage of Total Assets				
	1913	1919	1920	1921	1922
Average for 8 Berlin Banks ...	13·0	2·6	2·3	1·7	0·23
	1924	1925	1926	1927	1928
Average for 7 Berlin Banks ...	6·7	5·0	4·3	4·2	3·9

Even before the War, it will be a mistake to suppose that investments occupied quite a large portion of their business. Even in the pre-war years the holdings of securities, syndicate investments and participations in other banks were never very large. The average percentage of securities (including syndicate and bank participation) to the total assets in the case of nine Berlin Banks from 1907 to 1913 as shown in the following table clearly illustrates the position[2]:—

	1907	1908	1909	1910	1911	1912	1913
Average for 9 Berlin Banks ...	10·3	11·0	9·3	12·4	12·0	13·1	13·2

In the present times the proportions of long-term investments have fallen still lower. The importance of this part of their business is gradually receding into the background; and the

[1] The tables are based upon data given by P. B. Whale, *op. cit.*, pp. 155, 202, 223 and 275.

[2] Based upon data given by P. B. Whale, *op. cit.*

banks are steadily turning into deposit banks in the English and American sense of the word.

But more must not be inferred from this statement than is intended here. It has already been noted that the banks have not been indifferent and inactive when opportunities have come, as, for example, in 1926 and 1927. Indeed the recovery of German industry from the depression of 1925-1926 would have been difficult without the co-operation of banks with industry. Besides, it may be that the low proportion of shares and syndicates is due to the fact that these are being quickly passed over to the investing public. But it has to be acknowledged that the post-war German banks were tending to develop very much along the lines of the pre-war English deposit banks. This is evident not only from the comparative decline in the securities business noted above but also in the rapid increase in deposits and fall in capital and reserves. The following figures indicate a significant decline in the proportion of capital and reserves to liabilities, while the percentage of deposits and current account balances is comparatively rising[1] :—

	Capital and Reserves as Percentage of Total Liabilities.		
	1913	1927	1928
Average for 8 Berlin Banks ...	19·0	8·6 *	7·0 *

	Deposits and Current Account Balances as Percentage of Total Liabilities.		
	1913	1927	1928
Average for 8 Berlin Banks ...	62·1	85·1	86·1 *

The figures available for the principal German banks tell the same story of a remarkable decline in the proportion of capital and reserves to liabilities. The latter are seen to have

* Figures for 7 Banks.

1 P. B. Whale, *Jointstock Banking in Germany*, p. 275.

risen by 40% , while the former are little more than one-third of the pre-war figures[1] :—

	In Millions of RM.				
	1913	1925	1926	1927	1929
Capital and Reserves ...	2,338	666	763	813	836
Acceptances	1,850	259	350	435	453
Creditors (deposits) ...	6,759	4,906	6,528	8,128	10,399

The figures given above illustrate the recent tendency for German banks to depart more and more from the pre-war practice of combining the functions of commercial banking with those of investment banking in all its aspects. The continued increase in deposits is not certainly accidental. The German banks are working with funds deposited with them to a far greater extent than was ever before the case and have to exercise more and more caution. They have reduced their totals of securities and joint syndicate holdings and are conforming more closely to the recognised canons of commercial banking as adopted in England. The separation of commercial from investment banking functions is one of the most striking features of recent banking legislation in Germany The German Credit Act of December 5, 1934, has set a limit to bank holdings of real estate and speculative investments. Stocks, and bonds not admitted to German stock exchanges that are owned by a credit institution, must not exceed a certain percentage (in no case less than 5%) to current liabilities to be fixed by the Supervisory Board. Permanent participations and investments in property and buildings shall not exceed the capital and reserves of the credit institution.[2] Thus both law and practice are tending to reverse

[1] *The Times Trade and Engineering Supplement*, Banking Section, 28th June, 1930. Also the *Economist* (Banking Supplement), 12th May, 1928

[2] Sec. 17 (1) and (2), the German Credit Act of December 5, 1934. *Federal Reserve Bulletin*, January, 1935.

a banking tradition built up in the country over more than a century.

Technique of German "Industrial Banking":

The close relationship of German banks to industry commences from the very foundation of the industrial company. The banks lend their collaboration in founding almost every important company whether in the case of converting an already existing private enterprise into a jointstock company or of exploiting an absolutely new invention. The procedure is usually as follows: The bank first calls for full particulars about the industrial concerns and then finds some authority, not of its own staff, to investigate. The German banks, contrary to general belief, employ no staff of industrial experts. The expert is usually the director or manager of another industrial company connected with the bank. If, for example, it is a sugar factory, remarks Dr. Jeidels, the bank will ask one of its clients in the sugar industry for the favour of recommending somebody from his own staff.[1] "If the bank, after examination, decides to found the company, it draws up the scheme of financing, determines the amount and the type of capital to be issued and then in some cases itself takes a part of the shares into its security portfolio with the idea of issuing them at a later date."[2] In this way the founding bank becomes the issuing bank.

The origin of this intimate connection between a bank and an industrial enterprise lies in the opening of a current account for the latter. This current account, it must be noted, is not identical with the English cheque account. As Mr. Whale has pointed out, a current account relation in Germany is said to exist between the bank and its client "when money claims arise on both sides and these claims are not settled individually but

[1] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, pp. 147, 187.

[2] *Minutes of Evidences*, Committee on Finance and Industry (Memorandum on German Banking by Dr. J. Goldschmidt), Vol. II, p. 148.

are treated as items in an account, of which the balance is struck periodically. Once this balance is determined, the several debts on each side are considered to be settled and there emerges in their place one claim and one (equal) debt."[1] Interest is reckoned on both sides of the account.

The current account credits, though generally for short term only, are occasionally time credits and are granted more or less for long periods. Such long-term credits are generally preparatory for future loans; they represent in principle advances on future issues. Thus the German firms depend on their current account advances not only for working capital purposes but also for extension and replacement of machinery in anticipation of recourse to the investment market. These current accounts represent a large portion of the total assets of the banks and in 1910 the total sum due on that account in the case of eight Berlin banks was about 41% of their entire assets.[2] No definite rules can be given as regards the collateral security required for credits of this kind. The credits are very often granted without any security at all. They are then based upon personal confidence in the efficiency and managerial ability of the businessmen as well as on the earning power of the concerns. Such unsecured credits are, indeed, considered best and safest by the German bankers and in 1929 constituted 25% of the total debts of the principal Berlin banks.[3] In the case of secured credits, the security demanded is usually of an easily realisable character, such as stocks and bonds quoted on the stock exchange or stocks of commodities. Sometimes first mortgages are also accepted.

The opening of the current account is the first link in the long chain of transactions between the banks and industry. From the moment the current account relation begins, the bank

1 P. B. Whale, *Jointstock Banking in Germany*, p. 37.

2 *Banks and Industry in Germany*, an article by S. G. Feodossief in the *Bankers' Magazine*, June, 1930.

3 *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 150.

closely follows the interests of its client's business. If the bank finds that its client has the value it has attributed to him, it renews and increases the credits from year to year. Credits at first short become longer and larger and as occasion arises, capital transactions—conversion into a jointstock company, issue of bonds and shares, direct participation, co-operation in management—all closely follow one after another.

Banking collaboration to industry is lent by issuing the shares and bonds of industrial enterprises. "The business of issuing industrial securities is the keystone of the vast structure of the industrial relations between banks and industry whose foundation is the current account business."[1] When the bank in England gives its name to a security, it assumes no responsibility for it. But in Germany the bank becomes responsible for the future development of the securities which it has issued. It cannot shirk that responsibility without damage to its reputation. In England the great bulk of the issues is made by the big banks, the name of the bank appearing on the prospectus. But that does not make the bank responsible for the issue. In the English system the banker is merely a receiver of subscriptions to issues but in Germany the making of an issue only represents one stage in the continuous relationship between the banker and industry. The banks in Germany can only introduce an issue by responsibly signing the prospectus along with the issuing company. They are members of the Stock Exchange. In applying for admission to its shares, a bank has to submit a prospectus bearing its own signature, which is subject to a close examination by the Stock Market Listing Committee. This committee is composed partly of representatives of Government departments and partly of representatives of banks and all departments of business life. The representatives of the introducing bank, being interested parties, are usually excluded from the examination of the prospectus.

[1] Riesser, *op cit.*, pp. 364-65.

This issue business is generally carried out by what is called in Germany a "Syndicate" or "Konsortium," comprising several jointstock banks and a number of provincial banks. They make themselves responsible for the issue collectively and they come together for that purpose into an association which is called a "Konsortium." Each member of the "Konsortium" has a certain quota and is expected in the case of the syndicate credit to advance a proportional amount. The majority of the short-term current advances are made by the banks individually; while these syndicate credits are mostly really large and long-term [1] One of the members of the banking syndicate is chosen as the "Leiter" or Director of the common transaction. The shares are not divided among the members but remain in the custody of the "Director" bank until they are sold out to the public.[2] The syndicate is generally formed for a certain period and on its termination the total profit or loss and any remaining securities are shared among the members in proportion to the participation which they have accepted in the issue. The net effect of the German banks working jointly in syndicates is much the same as that of the English underwriting system. This method of creating 'syndicates' not only tends to reduce the risk borne by a single bank by spreading it out among all the associated banks but is also remarkable, as Dr. Goldschmidt points out, in preventing one bank from granting credits unknown to the others. This acts as a financial brake on the concern which would not otherwise be obtained.[3]

It will be difficult to realise without personal experience what a feeling of intimate relationship and solidarity has developed between the German banks and industry. This co-operation has been built upon the bedrock of a spirit of mutual confidence that has grown between them, a spirit that has far out-

[1] *The Economist*, March 15, 1930, pp. 572-73.

[2] P. B. Whale, *Jointstock Banking in Germany*, pp. 45-46.

[3] *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 149.

stripped the question of immediate gain and has emanated from a genuine desire on the part of both to further industrial welfare as a whole. This feeling of solidarity and mutual confidence has found its practical expression in the representation of the banks on the boards of industrial and trading enterprises. "While the managing directors of the banks are generally on the boards of the most important enterprises, the next ranks in the hierarchy, the managers, are often delegated to the boards of the smaller companies, while branch managers are nearly always to be found on the boards of the local companies in their districts." In addition to the appointment of Directors, the banks sometimes appoint one of their employees as Departmental Manager, Secretary, Accountant or Engineer to the newly connected industry.[1] Not only do the members of the bank directorate sit on the supervisory board of industrial enterprises, but captains of industry are frequently invited to take seats on the bank Aufsichtstrat. This exchange of representatives is an important link between banks and industry. The bond between them is strengthened and thereafter they are joined together "for better or worse."[2]

It must be noted in this connection that the banker never gives his advice on purely technical or industrial questions but always on financial matters. As a rule the industrialist is responsible for the business and general management of the company and the banker is merely the adviser on financial questions. It is not in conformity with the spirit of the German Aufsichtsrat to go beyond that. In exceptional cases when the financial structure of the companies has been impaired, the banker has gone beyond but always involuntarily.

This exchange of representatives has often been described as an 'interlocking of directorates.'[3] But in view of the peculiar functions of the German Aufsichtsrat, such a description will not

[1] Dr. Nimenyi's Memorandum, Indian Central Banking Enquiry Committee, Vol. II (Written Evidence), p. 292.

[2] Riesser, *op. cit.*, pp. 366-67.

[3] Walter Leaf, *Banking*, p. 159.

be quite correct. Its functions are not quite the same as those of an English Board of Directors. It does not possess any executive, but only consultative and supervisory functions. It determines in consultation with the managing directors the general policy of the company. Everyone of the members has the right to demand information and carry out investigation.[1] From the members of the Aufsichtsrat are elected a Presidium and certain committees, such as the committee for credit business. A number of members of the Board and of these Committees are industrialists so that expert advice and special information about industrial matters can be obtained confidentially from them in the case of large credits.

The day-to-day work of the bank is done by the body of managers. " The policy of the bank, the business of the bank and the representation of the bank are in the hands of the managers." The executive management consists of " personally responsible partners " who are responsible for the liabilities of the bank with their entire fortunes and of managing directors (members of the Vorstand) in banks organised as limited liability companies. These managers have joint leadership. Every individual has to give his decision on great questions as to granting large credits and issues and other important things. In the case of important credits the approval of the Credit Committee which meets from time to time to discuss such credits is required. For small credits, the sole responsibility is assumed by the partners or directors. But when they are in doubt, or when they have to deal with important credits, *i.e.*, those that are over a certain amount, the Aufsichtsrat will be consulted, and the judgment of those members who are particularly experts about the company applying for credits will be sought. The management can always approach the Aufsichtsrat or invite some of its members for the purpose of consulting them and seeking their advice on important questions.

1 P. B. Whale, *op. cit.*, p. 61. Also *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, pp. 157-58.

From the data collected by Dr. Riesser we are able to form an idea of the extensive representation of the banks on the supervisory councils of industrial concerns. The Deutsche, for example, in 1911 had seats on the supervisory boards of 159 companies, the Schaffhausen'scher Bankverein on those of 148, the Disconto on those of 143, the Darmstadter on those of 132, the Dresdner of 120 and the Berliner Handelsgesselschaft of 123.[1]

The position of the banker on the boards of several competing firms is not incompatible with the independence of these concerns and the continuity of competition between them. This is due to the spirit of mutual confidence, already referred to, between the banker and the industrial traders. "It is the same," as Dr. Goldschmidt observes, "when you visit the doctor. He will never say anything about your illness to your friends. He knows very well that he must keep your confidence."[2] This position of the banker is very good for him as well as for the company. He can learn in the different companies the various methods, ideas and kinds of leadership. He can very usefully advise other companies and can very often settle differences between them. He can render really valuable service when schemes of amalgamations are being considered. He can always approach other bankers and have a discussion with them over the scheme not only as an interested party but also from the general economic point of view.

The membership of a large number of boards in this way gives the banker a broad view of industrial development and a wide experience, so that he is generally the obvious man with whom to discuss new financial transactions and schemes of business organisation. "His experience together with his capacity and advice proves a very valuable asset for the boards of his companies particularly when he through his confidential personal relations has a general view over the situation of competing

[1] Riesser, *op. cit.*, App. IV, pp. 897-920.

[2] *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 157.

similar enterprises and can therefore judge and estimate the value of measures and schemes of general industrial policy."

From the foregoing analysis of the technique of industrial banking in Germany, the following points emerge very clearly. The banks grant short-term as well as long-term loans but the short-term deposits are used as a rule for the short-term loans. Credits for long periods whether for new or old established concerns are generally raised by issuing shares and debentures and selling them to the investing public. The issue of shares has generally been preferred for permanent improvements. When capital has been required for improvements of considerable duration but yet terminating after the lapse of a certain time, the banks have raised it by issuing bonds redeemable by amortisation within a fixed period. These debenture bonds have been issued whenever comparatively long-term loans have been required for an extension or renewal of machinery.[1] The banks may sometimes take up shares and debentures in the first instance and may often keep the purchased securities in their portfolios for some time before attempting their sale. *But they do not generally hold them* permanently and ultimately dispose of them among the public. Whatever might have been the case in the earlier period, lasting participation has never been their policy with regard to industrial enterprises in the present times. Since the War at least they have far less capital locked up in industry than was the case in the pre-war days. A careful perusal of the recent balance sheets will show that short-term credits generally predominate. In fact there has been a startling increase of the short-term loans of the German banks in recent years—the increase being to a considerable extent accomplished at the expense of a decrease in long-term investments.[2] The German banker to-day is as much

1 Riesser, *op. cit.*

2 M. B. Northrop, *Control Policies of the Reichsbank*, pp. 116-18.

The short-term loans of the German banks increased from 19,608 million RM. in 1913 to 20,429 million RM. in 1932; while the long-term investments declined from 26,424 million RM. in 1913 to 16,661 million RM. in 1932.

reluctant to tie up his funds permanently in industry as any other banker anywhere else in the world.

Diversified Activities of German Banks :

A study of the annual reports and balance sheets of the German banks clearly shows the diverse lines of business that they carry on. It seems incredible to one schooled in the simple traditions of English deposit banking, how the banks are at all able to carry on such various lines of business appearing to be extremely risky and speculative The diversified activities of the German banks and their intimate alliances with trade and industry involve them in heavy credit engagements as well as in investments which do not often represent readily realisable assets. The union of short-term banking with the provision of long-term capital has made them the target of severe criticisms.

In some cases the banks undoubtedly incurred enormous losses. But these were principally due to their own errors and hazardous ventures. In granting credits the principle of distribution of risks was generally disregarded in such cases. When a bank gives too much credit to one industry or even to one branch of it and when that single industry or establishment goes wrong, the result is necessarily disastrous. Thus the Leipziger Bank and the Dresdner Kreditanstalt owed their failures to the extension of excessive credit to single companies. The misfortune of the Darmstadter und National Bank in 1931 was similarly due to the collapse of its biggest borrower "Nordwolle." The larger banks often suffered heavy losses in connection with the development of some real estate companies, but their solvency could never be questioned.

Generally speaking, the enormous amount of share capital and reserves of the big credit banks, the solidarity of interest and the efficient control exercised by the authorities made it almost impossible that they would be shaken by any catastrophe. We have already pointed out that though they made both short

and long loans, they did not as a rule use their short-term deposits for the long-term investments. They issued shares and debentures for the purpose of raising the long-term credits. Here also we find that their policy was never to hold willingly the securities permanently on their own account. Only a very small proportion of capital and reserves was employed for this purpose. Through a skilful management, this small proportion was invested, realised and re-invested in various shares.

Besides, whenever the risks of immobilising their funds appeared to be very great, they departed from their traditional methods of participation and helped to establish subsidiary companies either in conjuction with industrialists or foreign capitalists. They often sought to provide relief by mediating loans from abroad, as during the years after stabilisation, when industries were suffering from scarcity of long-term capital. In September, 1927, the Deutsche Bank, with the assistance of Dillon Read & Co., raised in New York a five-year loan of 25 million dollars with the purpose of re-lending the proceeds to middle-sized industrial concerns in Germany for a similar term. Shortly afterwards the Commerz-und-Privat Bank raised a 10-year loan of 20 million dollars through the Chase National Bank for the same purpose.[1]

The history of German banking has amply demonstrated that it is possible for banks to play a large part in industrtal financing without immobilising their funds. It has been frankly recognised that "without the vigour and daring initiative of the banks the present proud edifice of German national economy could not have been erected in so short a time."[2] "It should never be forgotten," remarks Dr. Goldschmidt, "that Germany owes the great industrial development of the sixties, the nineties and the first decade of this century in a large measure to what one may describe as the 'entrepreneur spirit'

[1] P. B Whale, *op. cit*, p. 272.

[2] *Deutsche Oekonomist*, quoted by Mr. Whale, *op. cit.*, p. 331.

in banking."[1] The same 'entrepreneur spirit' was urgently called for after the War for the great work of reconstruction and rehabilitation of industry. The entire economic situation was shattered by the War, capital was lost, consumer demand was lacking and the technical basis of industry was undermined. The banks generously responded to the call of industry and stood by it firmly in the hour of its peril. Once again during the serious crisis which enveloped German industry during 1925-26, it was this same spirit which brought about its splendid recovery.

Reasons for the System of "Blending of Functions":

If the German banks "live under this system of the blending of functions and the confusion of risks," it is neither because they have preferred it to others nor because they have considered it more suited to the aims of national economy. It is because they could not be otherwise. They are so to speak "daughters of necessity"[2]—a product of numerous historical circumstances. The German banking system has been built up and organised as a consequence of the general economic evolution of the country. The economic situation in Germany was different from that in England and other old capitalist countries. In England, the process of industrialisation was spread over a pretty long time and there was a mass of dormant capital seeking investment. Industry had merely to ask for it for employment. But in the case of Germany her industrial revolution had marched more rapidly than the formation of capital. Before 1830 there was scarcely any trace of industrialisation in the country. It is from the middle of the 19th century that we meet with the first awakening of German industries. Changes were rapidly taking place about that time

[1] *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, p. 148.
[2] Henry Hauser, *Germany's Commercial Grip on the World*, p. 65.

in Germany. The whole system of communication was revolutionised by the use of railways; several of her industrial branches were transformed; and by means of the Zollverein, unification was achieved in the economic territory. All this paved the way for the expansion of German industry and gave a great impetus to large-scale production. The jointstock company is admirably suited for large-scale trade and industry and hence the rise of jointstock enterprise in Germany also dates from this period.

The rapid economic expansion created a new and enormous demand for capital and credits of all description. The funds of the general public were too meagre to meet this demand. Even in the case of those who had the necessary funds, they were neither willing nor fitted to become progressive entrepreneurs; nor would they trust their funds to those who had the necessary qualities. Hence there was place for an agency which would secure the confidence of the public and use this confidence to divert their capital to sound industrial undertakings. The existing financial organs were ill-adapted for this task. The banking system of the country consisted mainly of the small private banks, the note-issuing banks, the great bankers of the Rothschild type and some other banks of intermediate standing. Industry could not expect assistance from any of them. The private bankers advanced funds neither for a long period nor on a large scale. The resources of the note issuing banks were not suitable for long-term investments. The other great bankers of the Rothschild type stood aloof from struggling business concerns and were engaged in financing Governments. There was thus a serious gap in the financial system. The position and means of the existing credit agencies were not at all equal for the growing needs of commerce and industry. The German credit banks stepped into this vacant place.

The close relations between banks and industry were an outcome of the peculiar conditions of the country. The banks were obliged to concentrate their activities almost wholly upon

industry. They could not exert any influence upon agriculture because of the Landschaften. They were shut out from small trading and commercial enterprises because of the rapid development of the co-operative societies. If they had in the beginning devoted themselves solely to deposit operations, they would not have been able to carry on business. Germany in those days consisted of poor States where moneys on deposit had little scope for circulation. The banks, therefore, had to take upon themselves the task of financing the industries of the country. They were, so to speak, born as banks for industry.

CHAPTER III

BRITISH BANKS AND THE FINANCING OF INDUSTRIES [1]

The intimate relationship between banks and industry which was found in the preceding chapter to be characteristic of the Continental banking sytsem is unknown in England. The British banks consider that their proper function lies in the provision of current finance for industry. Short loans in the form of an overdraft or in the form of a separate loan account have been readily granted by them. But it has never been their policy to furnish the permanent funds required by industries for capital expenditure. They finance the purchase of raw materials and finished goods but they will not provide the funds for the purchase of plant and machinery. They are, as a rule, reluctant to lock up their funds in loans to industrial companies against debentures or real estate mortgages.

As the Committee on Finance and Industry have observed, British industry in the beginning of its growth had no reason to look forward to banking assistance. In those days, industry was carried on a comparatively small scale and on a family basis. Capital for industry was mainly furnished out of private resources and profits were employed to build and expand it. In so far as it required banking facilities it found them from the family banks which had their headquarters in the provinces where the new industries flourished. Besides, there had existed in the

[1] The substance of this chapter was published in the form of an article in the *Modern Review*, August, 1931 (revised and re-written)

country for many years a large class of investors with money to invest who were not entirely dependent upon banks for the selection of their investments but who exercised an independent judgment as to what to invest in.[1] These made it unnecessary for English banks to embark upon industrial ventures like their German rivals. It may be recalled that in Germany and other countries of the Continent the only institutions in a position to satisfy the long-term financial needs of industry were the banks. But in England the case was different. When the English jointstock banks developed in the middle of the last century, they were not the only financial bodies. A capital market had already been in existence and its machinery had been developed more and more in the course of the following years. Supplies from the English capital market had not to provide the fixed capital required for industry simply because there were ample opportunities for obtaining it elsewhere. Thus the English banks came to be confined to performing the functions of pure deposit banks and left a good deal of other business performed ordinarily by Continental banks to specialist institutions in the capital market. Deposit banking, unlike Germany, became segregated from investment banking. The industries in England are not only not dependent upon the banks but they look upon any interference from them as a disgrace and a sign of potential insolvency. In Germany on the other hand, a high degree of control was often exercised by the banks over the associated industries. In fact, this control was bound up with and largely a sequence of the assistance afforded by them. In England such interference and control by the banks would never have been tolerated.

The very constitution of the English banks—the system under which they work—has kept them generally aloof from industrial financing. They are not at all adapted for that kind of business. The whole system is based upon deposits repayable on demand or at short date. The duration of English bank

[1] Report of the Committee on Finance and Industry, 1931, cmd. 3897, p. 162.

loans has, therefore, to be necessarily short. In Germany and indeed in the Continent the cheque system is not so developed as in England. The banks there are not faced like their English *confrères* with a large amount of their deposits being repayable at a moment's notice. The English banks, again, work with a far smaller amount of share capital and reserves than the Continental banks. The paid up capital and reserves of the German banks, for example, were 45 % of their liabilities at one time ; and on the same date the proportion in England was 9 % and later even 7 %.[1] These are funds which are at their own disposal and not at all subject to calls by depositors. The Continental banks, having less deposits at call and working with larger resources of their own, have been able to extend their trading and industrial ventures without serious risk to the depositors. With enormous liabilities at call and short notice, the watchword with the English banks is safety and liquidity and as a rule they will not engage in any transactions involving a 'lock-up' of their resources. They have to invest their funds, generally speaking, in first class bills having a maturity of not more than three months and in gilt-edged securities. They cannot justifiably and with safety tie up their resources in ventures which, however promising, are untried, untested and, therefore, speculative. There is another point which should also be noted as presenting a contrast to the German practice. The English banks consider investment banking so far outside their province that they will even repudiate responsibility for prospectuses under which their name appears. But in the case of Germany the general public invest mainly through their banks, and there is no chance of issues being successful unless backed by the name of one or other of the leading credit or private banks, which also accept responsibility for their issues.[2]

[1] H. S. Foxwell, *Papers on Current Finance*, p. 103.

[2] *The Economist*, 18th January, 1930.

The Issue Houses and other Sections of the English Capital Market:

The issue houses or merchant bankers are an important section of the English capital market. But they are directly associated with British industries only to an insignificant extent. Their chief connections are with Foreign and Colonial Governments and municipalities. They are more interested in governmental and quasi-governmental loans than in industrial flotations and in overseas rather than in internal issues." [1] So far as the provision of long-term capital at home is concerned, they prefer to deal with municipalities and fight shy of ordinary home industrial propositions. Many ventures with excellent prospects have been laid before them only to be rejected.[2] So far as they assist British industries at all, they confine their support only to the largest concerns, that is, to those bodies which probably require their help in the least. But, as Prof. Clay has rightly observed, the great majority of the firms are small and medium sized concerns, so that, for the greater part of British industry, the services of the issue houses are not available. Besides, most of the issue houses are at the same time accepting houses. In the interests of their acceptance business, they have to keep their assets in a highly liquid form. It is never possible for them to "nurse" an issue. They cannot afford to make an issue which will not go off but will be left in their hands; and, therefore, whatever they take, is taken with the expectation of disposing of it as quickly as possible.[3]

1 *Cf.* Prof. H. Clay, "Their experience and association make them on the whole more interested in new issues of capital for overseas clients rather than the diversion of the flow to the industrial provinces of England"—Lect. IV, "Some Aspects of the World Depression," *Journal of the Institute of Bankers*, February, 1932.

2 F. Lavington, *The English Capital Market*.

3 Henry Clay, "Some Aspects of the World Depression," Lect. IV, *Journal of the Institute of Bankers*, February, 1932, p. 97.

For all these reasons, it has been urged that the utility of the issue houses to British industry is not very great.[1] For a long time there has been a wide-spread feeling that if they were to give more attention to British home industries and the marketing of their securities, the latter would be highly benefited as an adequate supply of capital on reasonable terms would then be assured for them.[2] In the present state of depression when the financial needs of industry are all the greater, their scope is far more restricted. In consequence of rationalisation British industry needs to obtain in the long-period capital market a considerable amount of capital. The issue houses, Prof. Gregory rightly observed, with their international obligations, could hardly be expected to satisfy the growing needs of British industry for this long-term capital.[3]

Besides the issue houses, the company promoters; investment trusts, financial companies and insurance companies are important sections of the capital market which play an active part in industrial financing. But it must be frankly recognised that these finance houses and investment trust companies have neither the standing nor the resources which may enable them to approach near enough to the activities of the Continental banks in the sphere of industrial financing. They have no permanent interest in the welfare of their industrial customers. In this connection the ill-fated transaction of the Austin Friars Trust, the "United Steel," may very profitably be compared with the flotation of the "Vereinigte Stahlwerks" backed by all the leading banks in Germany.[4] As regards the facilities offered by the company promoter they are a mere makeshift and highly inadequate. "His methods of operation contain within themselves strong tendencies to overvaluation and heavy marketing costs." When a new company is floated

1 Parker Willis and B. H. Beckhart, *Foreign Banking Systems*, p 1230.

2 H. S. Foxwell, *Papers on Current Finance*, pp. 128-29.

3 *Minutes of Evidence*, Committee on Finance and Industry. Vol. II, p. 293.

4 *The Economist*, March 1, 1930, p. 450.

by a promoter, he is primarily concerned with the ultimate success of the issue and not with the ultimate earning power of the venture. His interest is focussed on the price at which he buys from the vendors and at which he sells to the public.[1]

Committee on Financial Facilities for Trade:

Ever since the Great War, a feeling had been growing in England that all was not well with her financial system—that there was a serious gap in it. The British banks, as they were constituted, could not furnish the means whereby industries could effect their necessary extensions and reorganisations, and there was hardly any institution which could provide these long-term financial facilities.

The need of rehabilitating British industries after the Great War accentuated the feeling and an important Committee of the Board of Trade was appointed in 1916 with Lord Faringdon in the Chair to investigate the question of financial facilities for British industries and the part played by the British banks in their provision. The Committee observed in their Report (signed August 31, 1916) that the British banks afforded liberal accommodation to the home producer and the bankers were not shy in making advances on the strength of their customers' known ability and integrity and the charges for accommodation were often lower than the corresponding charges in foreign countries.[2] But they frankly recognised that British manufacturers might often be in need of finance of a kind which the jointstock banks with their peculiar liabilities could not prudently provide. Hence the Committee concluded, "There is ample room for an institution which, while not interfering unduly with the ordinary business done by British jointstock banks, by Colonial banks, etc., would be able to assist British industries in a manner that is not

[1] F. Lavington, *The English Capital Market*, p. 213.

[2] Report of the Board of Trade Committee on Financial Facilities for Trade, 1916, cd. 8346, para. 3.

possible under existing conditions" and they recommended the formation of a new bank to fill the gap. Such an institution, it was believed, would assist British industry and manufactures in a variety of ways. It would take a leading part in the inception of transactions and assist in connection with the machinery of overseas business; it would provide the necessary finances for extensions of existing plant and amalgamation or co-ordination of existing works so as to reduce cost of production; it would assist these works to obtain orders abroad and give them reasonable financial facilities for executing these. But both in connection with enlargement of works and financing of contracts, assistance should be forthcoming when a 'lock-up' of capital for an indefinite period was not involved. In the case of young men with some little means of their own, it would, after careful examination of credentials, also grant larger and longer credits than had been customary with existing banks.[1]

A concrete scheme for the new institution was put forward by the Committee. It was to be called the British Trade Bank and to be constituted under Royal Charter. Its chief features, as outlined in Para. 24 of the Report, were to be as follows :—

(1) It should have a capital of £10,000,000, the first issue being from £2,500,000 to £5,000,000, upon which in the first instance only a small amount should be paid up but which should all be called up within a reasonable time. A further issue should be made afterwards, if possible at a premium.

(2) It should not accept deposits at call or short notice.

(3) It should only open current accounts for parties who were proposing to make use of the overseas facilities which it would afford.

(4) It should have a foreign exchange department where special facilities might be afforded for dealing with bills in foreign currency.

1. Report of the Board of Trade Committee on Financial Facilities for Trade, 1916, paras. 5, 8, 16 and 17.

(5) It should open a credit department for the issue of credits to parties at home and abroad.

(6) It should enter into banking agency arrangements with existing Colonial or British Foreign Banks, whenever they would be concluded upon reasonable terms.

(7) It should be equipped with an up-to-date Information Department, which might properly be called a Bureau d'Etudes. It would not necessarily deal with schemes in which the institution proposed to take financial interests but it might be made a centre for investigation of projects on behalf of others. "One of the chief objects of the Bureau would be the organisation and keeping up-to-date of returns as to the status of firms abroad." It should obtain the earliest information from abroad about new business openings, large contracts offering, State and other loan and issue proposals. It would also have to undertake the examination of industrial projects, availing itself in this connection of the services of the eminent consulting engineers, consulting chemists, etc.[1]

(8) It should endeavour not to interfere in any business for which existing banks and banking houses provided facilities and it should try to promote working transactions on joint account with other banks and should invite other banks to submit to it new transactions, which, owing to length of time, magnitude or other reasons, they were not prepared to undertake alone.

(9) Where desirable, it should co-operate with the merchant and manufacturer and possibly accep trisks upon joint account.

(10) It should become a centre for syndicate operations, availing itself of the special knowledge which it would possess through its Information Bureau.

(11) It should receive Government recognition as much as possible without coming under Government control.

[1] Report of the Board of Trade Committee on Financial Facilities for Trade, 1916, para. 10.

If financial assistance were given by the Government to undertakings in connection with what were known as "key" industries, the business should, if possible, be done through the medium of the Institution, and it should be appointed an agent for carrying through foreign, commercial and financial transactions in which the Government might be interested.[1]

In the financial operations of the Institution the desirability of assisting British trade and of placing with British manufacturers orders in connection with new undertakings was to be always borne in mind.[2]

The British Trade Corporation :

The British Trade Corporation was the outcome of these recommendations of the Committee. It was established in April, 1917, with a Royal Charter with a capital of £2 millions and an influential board of directors under the governorship of Lord Faringdon. According to its charter of incorporation, it was established for a term of 60 years for the purpose of carrying on the business of trading and banking in any part of the world.

A considerable misapprehension seems to prevail about the functions which the British Trade Corporation was to perform in relation to British industries. It has been frequently viewed as the first institution to be formed in England with the object of providing long-term credits and technical advice to British industry through a body of experts, standing in almost the same relations to national industries as the German banks do in Germany. But such a view misunderstands not only the relations of the German banks to industry but also the functions that the Institution was desired to perform in the industrial field. The German banks neither employ a staff of experts to examine business propositions nor do they generally furnish anything but

[1] Report of the Board of Trade Committee on Financial Facilities for Trade, para. 18.
[2] *Ibid*, para. 22.

financial advice to industries.[1] In ordinary circumstances advice in technical matters is considered to be outside their sphere. A careful perusal of the Faringdon Committee's Report gives one the impression that the Corporation was designed with the primary object of stimulating the export trade of the country rather than the development of home industries. The anxiety to forestall the enemy countries in any possible attempt to regain their lost position in the world of commerce and also to recapture from them, if possible, the overseas markets for the purpose of British trade, was mainly responsible for the formation of the Institution. As regards the provision of long-dated capital, it may be recalled that the Committee were desirous to avoid a "lock-up" of capital for an indefinite period even for the necessary enlargement of firms. The subsequent history of the Corporation also shows that it made it its concern to provide financial accommodation to merchants and traders to execute their contracts with foreign countries rather than to home industries to effect their extensions and reorganisations. At the first Annual meeting held on 31st January, 1918, its Governor also expressed a genuine desire to assist the export trade of the country by providing financial assistance as far as the means of the Corporation would permit. The Corporation, he observed, would be particularly anxious to furnish the commercial community with information that might not be readily available from other sources ; and it was further hoped that, when business would revive, it might be made the pivot upon which important syndicates for great industrial developments at home and abroad might revolve. Several of the jointstock banks carrying on business at home and abroad were among its shareholders and the Governor trusted that the scheme of co-operation which made the German banks so great a power in the past would be followed here also. But the venture did not fulfil expectations. From

[1] See *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, pp. 147, 287.

the information which is available, it does not appear that the Corporation rendered any substantial assistance to home industries. Its history was singularly unhappy and although it was supposed to have considerable prospects, it ended in a failure. It did not help British industry to any appreciable extent to tide over its difficulties.[1]

The Corporation failed to achieve its original objects. The purposes which were adhered to appear to be as follows[2]:—

(1) Provision of overseas banking facilities where British institutions were not active:

(2) Encouragement of the export trade directly by a closer union of banking and commerce than was common in England, as for example, by wedding a banking company to its trading affiliates:

(3) Entry into trading fields formerly held by the enemy to secure the same for British manufacture.

To achieve these purposes the following subsidiary companies were organised: (1) The Anglo-Brazilian Commerce and Agency Co., (2) The Portuguese Trade Corporation (1918), and (3) The Levant Company. But all these ventures proved to be unfortunate investments and the sums invested in them had to be written off.[3] The disordered state of European trade and finance that had followed in the wake of the War seriously interfered with its business. The subsequent post-war slump dealt it a heavy blow. Losses were considerable and its capital of £2,000,000 had to be reduced by one-half. The Corporation was singularly unfortunate. As Dr. Robinson has observed, "Its knuckles were rapped whenever its interests extended in overseas areas for the reason that

1 See Evidence of Mr. Beaumont Pease, Chairman of the Lloyds Bank.—Committee on Finance and Industry, *Minutes of Evidence*, Vol. I, p. 131.

2 L. R. Robinson, *Foreign Credit Facilities in the United Kingdom*, 1923, pp. 51-52.

3 The only successful venture appears to be the Trade Indemnity Company founded in March, 1918. Its stock was held for the most part by the Corporation and it subsequently grew to be more important than the parent company.

the dramatic ups and downs of world business and the running sores of European politics could not be anticipated at the time when its far-reaching programme was undertaken to meet an existing need." [1]

Dr. Walter Leaf, writing a few years later, in 1926, remarked with reference to the Corporation that after several years of experience it could hardly be claimed that the operations of the Company had been so successful as to show that there was a real need for it.[2] In the same year the British Trade Corporation and the Anglo-Austrian Bank were amalgamated together into a new company under the name of the Anglo-International Bank. The new bank was registered with a nominal capital of £2,000,000; the paid-up capital was £1,960,000, of which 610,000 shares and 750,000 shares of £1 each were issued to the shareholders of the Anglo-Austrian Bank and the British Trade Corporation respectively.[3] But the new Bank could hardly be expected to fulfil the high aim with which the British Trade Corporation was incorporated, *viz.*, "the setting up of a new tradition in the financing of British trade and industry." That experiment definitely failed.[4]

Balfour Committee on Trade and Industry:

The increased acuteness of international competition for overseas markets during the post-war years again brought to a head this question of long-term financial facilities for British industry. Some complaints were made before the Balfour Committee on Trade and Industry that adequate means for financing long-term credits were not available for British business. It was pointed out that in consequence of the practice of the Continental banks to ally themselves closely with industrial

[1] L. R. Robinson, *op. cit.*, pp. 58-59.
[2] Walter Leaf, *Banking*, p. 168.
[3] *The Bankers' Magazine*, 1926, p. 545.
[4] *The Economist*, September 4, 1926, p. 382.

enterprise and to arrange long-period credits, British manufacturers of certain classes of capital goods were sorely handicapped owing to the absence of any means for financing long-term credits in respect of their export. Like the Financial Facilities Committee, the Balfour Committee concluded that though the trend of evidence was that there was no lack of loanable capital available for the use of British industry at moderate rates of interest and on reasonable security, yet it appeared, from certain complaints made as to the inadequacy of long term financial facilities, that there was a "gap in the machinery available for the financing of industry"; and they recognised that there was a great demand that this existing gap in the financial arrangements should be filled.[1]

Committee on Finance and Industry:

Once again in the peak of the world crisis when England was passing through difficult years of industrial stagnation and acute unemployment, the old question of the provision of long-term financial facilities for British industry was revived, and along with it, the question of the adequacy of banking assistance to industry was also brought to the foreground. The charge was made against British banks that their policy of holding back advice and financial support was sorely impeding the rationalisation and reorganisation of British industry. There was an undercurrent of feeling that the banking system was highly unsatisfactory in its industrial loans policy and the complaint was that it was not adequately ministering to the needs of industry. The British basic industries, *viz.*, cotton, wool, coal, iron and steel, it was pointed out, were faced with serious difficulties as never before, and the question of a reorganisation or amendment of British banking practice as regards industrial financing was canvassed in many quarters.

1 *Final Report of the Committee on Industry and Trade*, 1929, pp. 47-49.

The feeling was so widespread that it engaged the attention of the Government of the day. An important Committee was appointed in 1929 by the Chancellor of the Exchequer which was to investigate among other things the whole question of the relation between British banks and industry. The Committee known as the Committee on Finance and Industry had the benefit of having the Rt. Hon'ble H. P. Macmillan as its Chairman and included in its personnel the eminent economists and business men of the day.

British Banks and their Increasing Interest in Industry during 1922-1930:

A year later, in the course of a much-discussed speech to the Manchester Chamber of Commerce, Mr. J. H. Thomas, then the Lord Privy Seal, announced that the Government had arranged with the banks that help should be given to industries which were prepared for reorganisation and modernisation. "The City," said he, "is deeply interested in placing industry on a broad and sound basis and is ready to support any plans that in its opinions lead to this end. Industries which propose schemes conforming, in the opinion of those advising the City, to this requirement will receive the most sympathetic consideration and the co-operation of the City in working out plans and finding the necessary finance."[1] It was, in effect, an open invitation on behalf of the City to business and industry to come forward with real schemes of reorganisation and an intimation that the whole forces of British finance were for the *first time* prepared to stand behind industry in a forward move. The statement made by the Lord Privy Seal was of great significance, inasmuch as he said it was made with the authority and knowledge of the City. For, did it not indicate that the British bankers were thinking of making a departure from the traditions of British banking prac-

[1] Mr. Thomas's Manchester speech, 10th January, 1930.

tice in their contemplation to provide relatively long credits to industries? Indeed even before the historic pronouncement of Mr. Thomas was made, the banks of England during the past ten difficult years had not been entirely indifferent to the interests of industry. In several cases they had large commitments in a number of industrial concerns. As a matter of fact they had not maintained the same attitude of aloofness from industries in the post-war as in the pre-war days, and had considerably relaxed the conservative codes of commercial banking practice to which they were wedded. As Mr. Joseph Sykes has remarked, "The sharply crystallised English pre-war practice of making only short-term loans has perforce been modified by the exigencies of the specific incidence of post-war depression on certain industries."[1] In the case of many industries, specially cotton, wool, iron, ship-building and engineering. the banks found, after the collapse of 1920-21, that many of the loans which they had granted on the basis of early repayment were "*frozen*" for a comparatively long period. The banks were compelled to make further advances in order to safeguard the loans they had made previously. In an important paper read before the Royal Statistical Society, Mr. H. W. Macrosty also pointed out how this departure from the normal practice of only short-period lending on the part of the banks was the outcome of post-war conditions. After the collapse of trade began and during at least the greater part of the depression, there was no restriction of credit by the banks either in the United Kingdom or in the United States. When prices began to fall, the banks found it necessary to 'carry their debtors' in order to prevent an even more hideous collapse than what had happened.[2] As Mr. S. E. Thomas has observed in a recent work, "The British banks...... for some years responded liberally to the demands made upon them and afforded an unprecedented degree of financial assistance

1 Joseph Sykes, *The Present Position of English Joint-stock Banking*, p. 144.

2 Quoted by *The Economist*, December 25, 1926, p. 1117.

to industry.........vast sums were advanced by the banks in the hope that the help so given would enable concerns in which they were interested to keep going until an improvement took place in the general economic position of the country......... Indeed they had no choice in the matter."[1] Many instances may be given where the banks had not at all been unsympathetic to the ills of industry or unresponsive to its needs. They had not only made extended loans to the suffering industries, loans in many cases with no certainty to eventual repayment, but in some cases they had been obliged to take in hand the financial reconstruction of enterprises and make considerable monetary sacrifices by reducing their full claims. Indeed as Sir Arthur Salter has pointed out, "In Great Britain where the principle of avoiding long-term investments has been most insisted upon, the grant of renewable short-term credits to industries which have used them for more than genuine working capital purposes and could not repay them has at once frozen a substantial part of the nominally liquid assets of the banks and given them *against their will* the legal power of control over a large part of industry."[2] In many cases the reconstruction and rationalisation schemes in connection with certain industries were made possible by the action of the joint-stock banks. There was a definite effort on their part to overcome the difficulties which faced industries suffering from prolonged depression in obtaining additional capital for carrying through reorganisation schemes.[3] Mr. Holland Martin in the course of his Presidential Address before the Institute of Bankers in 1931 gave eloquent testimony to the important part played by some British banks in the recent reorganisation of industry and referred to it as "nursing back to health" a number of ailing concerns.

As regards the cotton industry, it was pointed out by Mr. S. S. Hammersley in the course of a speech before the

[1] S. E. Thomas, *British Banks and the Finance of Industry*, p. 141.

[2] A. Salter, *Recovery*, p. 96.

[3] *The Times, Trade and Engineering Supplement*, Banking Number, 28h June, 1930.

House of Commons in December, 1927, that there were 200 cotton mills in the hands of the banks. They had lent something like £15 millions to these concerns and a large portion of this money was unsecured.[1] In the course of a paper read before the Royal Statistical Society, Prof. Daniels and Mr. Jewkes also pointed out that the banks played an important part in financing a large proportion of the refloated companies in the Lancashire cotton industry. The refloatation of 129 companies was largely financed by overdrafts and loans.[2]

The coal, iron and steel industries were not neglected and in some reorganisation schemes the banks took a leading part. The fusions between Dorman Long and Bolckow Vaughan and between Guest Keen and Nettleford and Baldwins were due to the action of the joint-stock banks. The formation of the Steel Industries of Great Britain, Ltd., and of the English Steel Corporation also would not have been possible without their help.[3] A perusal of the annual speeches of the bank chairmen during the past few years will also bring out the fact that the financial stake of British banks in industries was not small. In the course of one such speech the Chairman of the Lloyds Bank stated that his bank granted new loans to the amount of £44 millions to 32 different industries between June, 1924 and June, 1925.[4] The analysis which Mr. McKenna gave of the Midland Bank's percentage distribution of advances in 1928 indicates the amount of assistance rendered by the bank to industry.

1 Speech of Mr. S. S. Hammersley, 19th December, 1927,—Parliamentary Debates, Vol 12, pp. 87-89.

2 "The Post-War Depression in the Lancashire Cotton Industry"—*Journal of the Royal Statistical Society*, Vol. XCI, 1928, pp. 176-79.

January, 1921.	£
Loans	17,056,700
Bank overdrafts	5,313,500
Debentures	1,200,000
	23,570,800

3 S. E. Thomas, *British Banks and the Finance of Industry*, p. 143.

4 Speech of the Chairman at the Annual Meeting, 192[illegible]

69% of its advances went to trade and industry while $16\frac{3}{4}$% only went to Insurance, Finance and Stock Exchange.[1] The leading bankers of the country in the course of their evidence before the Macmillan Committee also pointed out the large extent to which they had extended their assistance to British industry; and that in many cases such assistance was not of the character of temporary accommodation. Mr. F. C. Goodenough, Chairman of the Barclays Bank, admitted that many of the loans to the cotton industry were not liquid.[2] The power of the bank, he observed, had been strained in helping industries. Mr. Frederick Hyde, Managing Director of the Midland Bank, stated that the loans to the cotton industry continued much longer than they were intended when they had first started. The same thing happened with the ship-building and steel industries, though on a much smaller scale.[3] Mr. J. W. Beaumont Pease, Chairman of the Lloyds Bank, remarked that the Bank had some loans tied up in the heavy industries at the time. In shipping and ship-building the percentage of the bank's total advances was 2·49%. In the iron and steel industry also there was a small proportion of frozen loans. The bank assisted in a number of reorganisation schemes for industry and as a result had to do many things which according to banking principles it would never have done *de novo*. In some cases it even became an actual shareholder. In one instance the bank agreed to accept, in place of its debt which was covered by the debentures, half in income-debenture stock and half in preference shares. The large holding of preference shares turned the bank into a shareholder in the concern to that extent.[4]

Not to speak of the joint-stock banks, even the Bank of England has grown alive to the needs of the sorely stricken British industries. As Sir Ernest Musgrave Harvey, the Deputy

[1] Speech of Mr. McKenna at the Annual Meeting, 1929.

[2] *Minutes of Evidence*, Committee on Finance and Industry, Vol. I, p. 39.

[3] *Ibid.*, p. 68.

[4] *Minutes of Evidence*, Committee on Finance and Industry, Vol. I, pp. 131-32.

Governor of the Bank, observed in the course of his evidence before the Macmillan Committee, "For a long time past the Bank has been trying to discharge its part, as a special operation in these difficult times, to assist industry." Various industries approached the Bank through different channels and in many instances she has freely given the aid and advice which have been sought from her. Indeed the association of the country's Central Bank with certain schemes of industrial reorganisation is unprecedented in the banking history of England and is assuredly an extension of her functions which requires careful consideration. The Lancashire Cotton Corporation, an ambitious scheme for bringing about reorganisation in the American Section of the Lancashire Cotton industry, was the outcome of the initiative of the Governor of the Bank of England and had the direct financial support of the Bank. The part played by the Bank of England in particular and by the banks in general who were the largest creditors in bringing the scheme within the realms of practicability has been very important. In fact the preliminary investigations could not have been brought to a successful completion without the advice and help afforded by the Central Bank.[1] Coming to individual concerns, the Bank rendered unselfish assistance to the armament firm of Armstrong & Co., Ltd., and the steel firm of William Beardmore & Co., Ltd., in their reorganisation schemes.[2] The Bank of England had its own technical advisers, there were representatives of the companies, there were representatives of the banks interested, and a scheme was devised as the result of discussions among all these.

The Securities Management Trust (1929):

Towards the close of 1929, the Bank of England formed a subsidiary company, called the *Securities Management Trust*,

1 *The Statist*, February 2, 1929, p. 176.

2 Evidence of Sir E. M. Harvey, K.B.E., Deputy Governor of the Bank of England, before the Macmillan Committee.—*Minutes of Evidence*, Vol. I, pp. 52-53.

the entire capital in which was held by the Bank. The principal object of the Trust was to assist the process of rationalisation and reconstruction in industry. As Sir Ernest Harvey stated in the course of his evidence before the Macmillan Committee, "The objects of the Securities Management Trust are to advise industries, to examine schemes for rationalisation, reorganisation, etc., to advise where schemes may be unsound if we do think so, to the extent to which it is legitimate for us to do so, to provide in some cases some of the initial money, to ensure that schemes are of such a nature as to justify appeals for financial assistance in other quarters"—the intention always being to get these industries in a position in which they could appeal to investment credit. The distressed industries seeking help must first put their own house in order. The Company will not provide its own money or ask the investing public to do so in order "to bolster up any industry which in the absence of adequate reorganisation is in itself obsolete and inefficient or uneconomical and which has no chance of meeting on a proper competitive basis the competition of new and reorganized industries in foreign countries."[1] The Board of Directors is composed of business experts so that it may have the very best guidance with regard to industrial conditions and when occasion arises may have the proper machinery for examining the merits of particular schemes of industrial rationalisation which may require special financial support. The direction of the Trust's economic research was undertaken by Prof. Henry Clay. Sir Charles Bruce Gardner, who had a long experience of iron, steel and kindred industries, was appointed Managing Director.[2] When schemes are brought before the Company, they are at first examined by the directors who are the experts. They are then put up before the full directorate including the Governor and other representatives of the Court

[1] *Minutes of Evidence*, Committee on Finance and Industry, Vol. I, p. 52.
[2] *The Bankers' Magazine*, 1930, p. 729.

of the Bank. Thus it is made sure that the schemes are financially sound and their capital position is not saddled with prior charges. It is only then that the Court may find for them moderate amounts of initial cash. The sympathy and support of various financial circles have also been enlisted in this connection. It is never intended that the Bank will continue to exercise its parental control and guidance over the industry permanently. As soon as the industry has been put on its feet and can feel assured that it can fairly appeal to the investing public, the Bank will withdraw and secure the release of its money so that the same may be made available, if necessary, for the help of other industries. The industry, on the other hand, free from the Bank's supervision, will go back to its ordinary management and seek its finance from the ordinary sources. The idea behind the whole scheme is "to bridge the gap when the investing public will not take up an industry which is in a distressed condition."

The S. M. T. serves a useful purpose and has already become an intelligence department. *Since its inception it has* played a leading part in implementing and financing two important industrial rationalisation schemes, *viz.*, the Lancashire Steel Trust and the Wigan Coal Corporation. In the case of the former it took over the whole of the £500,000 'B' ordinary shares.

The Bankers Industrial Development Company (1930):

The establishment of the S. M. T. was followed, in April, 1930, by the creation of the *Bankers Industrial Development Company* with the Governor of the Bank of England as Chairman. It is a private company having a nominal capital of £6,000,000 divided into two classes of shares, 45 'A' and 15 'B' shares of £100,000 each. £4,500,000 have been subscribed by practically all the leading Deposit Banks and Merchant Bankers and Finance Houses and £1,500,000 by the Bank of England. The capital cannot be called up to the

extent of more than 25% except in the event of liquidation and the whole of the £1,500,000 subscribed by the Bank of England has to be paid up before the rest of the subscribers can be called upon to pay anything in excess of that 25%.[1] The general objects of the B. I. D. may be described as having to investigate and advise on all manner of financial, economic and industrial questions, to aid in the formation and carrying into effect of schemes and arrangements relating to the financing, development, co-operation, amalgamation, reconstruction or reorganisation of firms, companies and businesses of all kinds.[2] In practice its main function is to encourage schemes for the rationalisation of British basic industries when brought forward from within the industry.[3] The B. I. D. subjects every scheme of rationalisation it receives to a thorough and careful investigation from all points of view. It proceeds very cautiously, always taking account of the fact that money found for rationalisation in one place might have injurious repurcussions somewhere else. It frequently invites, as it did in the case of the steel industry, representatives of the trade in which the reorganisation is to take place, from the various districts, to participate in discussions with a view to clearing away difficulties and evolving useful lines on which the rationalisation should occur. When after a minute investigation the position and possibilities of the proposition have been carefully assessed, and it has been found to deserve the support of the B. I. D. it then tries to construct a security which it can offer to the public with its backing. In the case of such an approved scheme, however, it will not provide the necessary finances itself. It has not been constituted as an Industrial Bank with immense resources of its own for invest-

[1] Evidence of Sir Guy Granet —Committee on Finance and Industry, *Minutes of Evidence*, Vol. II, p. 288. The board of directors of the B. I. D. consist of (*a*) Baron Schroder of Schroders, (*b*) Mr. Peacock of Barings, (*c*) Mr. Wagg of H. Wagg & Co., (*d*) Sir Charles Bruce Gardner, (*e*) Sir Guy Granet

[2] Letter to the writer from Sir Charles Bruce Gardner, a director of the B. I. D., dated the 21st January, 1935.

[3] *The Times, Trade and Engineering Supplement* Banking Section, June, 1930.

ment in approved industrial concerns. The promotion of rationalisation schemes or their direct financing is not its business. It makes arrangements for the provision of the necessary finances through the existing agencies, obtaining all the new capital for industrial reorganisation through the ordinary investment channels.[1] Its functions are essentially those of an intermediary between industry and the capital market. Here again it is never intended that the B. I. D. should find the money recklessly or take the risk wholly, leaving the company without any responsibility at all. As regards the staff of experts necessary to examine the schemes of rationalisation that may be submitted to it, it entirely depends on the number and variety of the schemes considered and arrangements are made by the Bank as it thinks necessary from time to time. Although financial guarantee has not yet been contemplated by the B. I. D., it is apparent from the tenor of Sir Guy Granet's evidence before the Committee on Finance and Industry that it is not entirely precluded.[2]

The B. I. D. necessarily deals with big propositions. They have got to be schemes of rationalisation and even these will, under the Charter, relate to basic industries. Here again the initiative is never taken by it but comes from the industry itself. "It would be a dreadful thing," said Sir Guy, "if industry thought that here was a body of bankers and economists who were going to tell industry how they ought to be organized." Although in strict theory, it cannot do anything except receive a scheme which is submitted to it, as a matter of fact, it has to do a good deal of work by conversation and intercourse. Nothing is suggested initially by the B. I. D. but things are frequently discussed before they come up to it in the form of a scheme.

[1] *The Economist*, April 19, 1930, p. 875.

[2] Evidence of Sir Guy Granet.—Committee on Finance and Industry, Vol. II, pp. 288-89.

The B. I. D. is a unique body representative not only of every important bank and issuing house in the country but even of the Bank of England. It has been truly characterized as a national consortium of British bankers, "a partnership between the Bank of England and the leading Houses of the City formed to make available for British industry the amplest resources of the nation." [1] It was formed at the first instance for 5 years and its existence was extended in 1935 for a further five years, namely, until the 31st March, 1940.[2] It has made a good start and at the stage seems destined to play an important rôle in the reorganisation of British industry. A number of capital issues have already been made under its aegis. As examples of various schemes for which the B. I. D. has assisted in providing finance either by a public issue or by private arrangement, the following may be mentioned [3] :—

1.	The Lancashire Cotton Corporation ...	£2,000,000
2.	National Shipbuilders' Security	£1,000,000
3.	Stewarts and Lloyds, Ltd. (Corby scheme) ...	£3,300,000
4.	Guest Keen Baldwins, Ltd. (Cardiff scheme) ...	£2,032,000
5.	Partington Iron and Steel, Wigan Coal and Iron, Messrs. Pearson and Knowles, and Messrs. Ryland Brothers	£1,750,000
6.	Dorman Long & Co., Ltd., the South Durham Steel and Iron & Co., Ltd., and the Cargo Fleet Iron Co., Ltd., merger	£2,500,000

It must, however, be pointed out that the B. I. D. has to work under certain limitations. Its scope is rather restricted. It has adopted as one of its guiding principles that a scheme must relate to an industry or a complete section of it and not an individual enterprise. But a large portion of the industrial undertakings of the country are comprised of businesses of moderate

[1] S. E. Thomas, *British Banks and the Finance of Industry*, p. 150.

[2] Letter to the writer from the Secretary, Bankers Industrial Development Company, dated May 16, 1939.

[3] *The Statist*, December 22, 1932, p. 963; *The Economist*, December 22, 1932, p. 1190. It has recently assisted in the finance of the following schemes :—

(1) The Spindles Board—£2,000,000; (2) The New Jarrow Steel Co., Ltd.—£1,000,000; (3) John Summers & Sons, Ltd.—£4,283,185.

size which are in need of capital re-equipment and general overhauling. They are not sufficiently known to make a direct appeal to the market with prospects of success. The B. I. D. will not be of any help to them.[1] Again, the Institution is not in a position to perform one of the main functions of an ordinary issuing house, *viz.*, to support its issues in the market after their appearance. It is more akin to a bank than an issuing house, able to give guarantees, to spread its risks and to support its offspring. In this connection the fate of the debentures issued by the Lancashire Cotton Corporation may be recalled. They were at first quoted at a heavy discount. Besides, prosperous industries are neither entitled nor are they willing to apply for help to the B. I. D. which entertains applications for assistance solely from distressed industries as a whole—applications, it should be remembered, made on the initiative of such industries.[2]

As early as 1930, Mr. S. S. Hammersley, M.P., charged the B. I. D. with pursuing a policy of reconstructing industry through the weakest units, a policy which would lead to what he called aggregation of financial "lame ducks."[3] But it will not be quite correct to say that the B. I. D. has failed to fulfil the purpose for which it was created. It has in a large measure achieved a part of its object and may generally be said to have justified its existence. Sir Guy Granet assured the Macmillan Committee that it had done a great deal of good and really useful work. The advantage of the B. I. D. appears to consist in the fact that it has to assume risks which an ordinary issuing house cannot afford to do. A private issuing house will not issue a debenture on a new prospect. But the B. I. D. has to issue or find money for something which is based to a certain extent on estimates of what is going to happen in the future. It has got to issue securities which, although in its opinion quite good and

1 *The Banker*, April, 1931, p. 12.
2 *The Banker*, July, 1931, p. 10.
3 *The Economist*, September 27, 1930.

beneficial to industry, are such as a private issuing house cannot afford to issue. But the public has this assurance that, though the risks are of a character which an ordinary issue house would not put on the market, yet the scheme is one which bears the imprimatur, the hall mark of approval of a responsible body and put forward on their responsibility, if not on their guarantee.[1] Complaints have been made in some quarters that since its inception the Company has done comparatively little and has made only a very few issues.[2] But it is apt to be forgotten that it has got to proceed very cautiously. It has to conduct elaborate investigations into the details of the schemes presented to it for examination, the primary consideration always being to find out whether the grouping is going to effect substantial economies in production. All this must take a good deal of time to investigate and check properly. It has not a whole group of experts who can be employed to examine three or four schemes simultaneously. Sir Guy rightly observed, " I do not think we can go ahead and produce a scheme a week. The more one goes into it, the more one finds that it is really necessary to act slowly." As regards the charge that the scope of the B. I. D. is limited to very large schemes of rationalisation relating solely to basic industries, we have the assurance from Sir Guy that in case of a scheme being considered to be beneficial to industry, he would not care whether it was a basic industry or not. The influence of the B. I. D. in the industrial field must not, however, be placed too high. The authorities of the Company do not themselves claim that it will act as a panacea for all the industrial ills of the country.

From the preceding discussion it is abundantly clear that in recent times the British joint-stock banks and even the Bank of England have associated themselves with industries in a manner

[1] Evidence of Sir Guy Granet.—Committee on Finance and Industry, *Minutes of Evidence*, Vol II.

[2] See *The Banker*, April and July, 1931, p. 290.

they had done never before. Their attitude towards industry appears to have been considerably modified. The frequent charges levelled against them that their attitude to industry is "unduly rigid, unsympathetic and detached" can no longer be strictly maintained. During the decade 1920-30 we have seen above that the commitments of the British banks in national industries have not been small. Bank chairmen, in their annual speeches of 1929 and 1930, pointed out that the financial help rendered by the banks in connection with rationalisation schemes had brought them near to "saturation point" and that they could not wisely extend their commitments further in that direction.[1] Indeed the banks entered the industrial field in such a manner that they have been accused of deviating from the recognised canons of commercial banking. In some quarters a feeling is even evident that if the bankers are to be criticised for their attitude towards industry during the past few years, it will be for their too great a readiness to stand by industry in the matter of banking facilities.[2] Mr. C. T. A. Saad, Asst. General Manager of the Midland Bank, maintained in a recent speech in defence of banking in relation to industry that banks erred on the side of giving too much credit rather than too little.[3]

The recent trend in British banking practice must not, however, be interpreted as a deliberate departure from the pre-war traditions of English deposit banking. It will be misleading to say, as is often observed, that the British banks are approximating in any way to the pre-war German banks just as the post-war German banks are becoming akin to the English deposit banks as they stood before the War.[4]

The orthodoxy of British banking remains unshaken and unbroken. There is ample evidence to indicate that the bank

1 *Cf.* the Presidential Address of the Hon'ble Rupert Becket of Manchester and District Banker's Institute on 10th January, 1930.

2 *The Bankers' Magazine*, February, 1930, p. 166.

3 Quoted in the *Bankers' Magazine*, July, 1934, p. 60.

4 See Parker Willis & B. H. Beckhart, *Foreign Banking Systems*, p. 43.

chairmen consider such extension of British banking activity as an infringement of the pure theory of banking and would not under any circumstances approve of it even though it were advantageous for industry. While they repudiate the suggestion that banking assistance to industry has been insufficient, they have emphatically pointed out that it is not the function of banks to find the permanent funds required for capital expenditure. A perusal of the recent annual speeches of the Chairmen of the Big Five shows that they are still clinging to the traditional views of British banks being essentially receivers of short-term deposits and makers of short-term loans. Mr. Beaumont Pease of the Lloyds Bank, Mr. Goodenough of the Barclays and Sir Harry Goschen of the National Provincial specially emphasized in their recent addresses that the functions of the English joint-stock banks had always been to provide money for the current needs of industry and they viewed with alarm any change in their policy which would lock up their resources in machinery, bricks and mortar. They stressed the point that the banks had neither the necessary detailed knowledge of the conditions of an industry as a whole nor were they sufficiently acquainted with the technicalities and hence they could never be advised to embark on a policy of industrial financing. The main tenor of the evidence of the prominent bankers before the Committee on Finance and Industry was also to the same effect. Mr. Goodenough thought it extremely undesirable that British banks should act in the manner of German banks and issue long-term loans for British industry. "It would militate against the liquidity of the banks." [1] Mr. Beaumont Pease regarded the recent extension of the activities of the British banks as definitely a departure from the pure theory of banking which was forced upon them by the exigencies of the moment, and he believed that developments of that kind would be wholly inappropriate for banking

[1] Committee on Finance and Industry, *Minutes of Evidence*, Vol. I, p. 39.

institutions.[1] Not only the chairmen of the joint-stock banks but the Governor of the Bank of England also consider that the cultivation of any relations with industry on the lines of the German banks or of the American security affiliates is wholly unsuited to British tradition, mentality and capacity.[2] The British bankers are averse to the granting of credits for a period longer than a year, for such would be of the nature of permanent capital. It must also be noted in this connection that whenever the banks have been obliged to lend for comparatively long periods to industry, they have made it clear that either such loans were not considerable or that they were forced by circumstances to make them absolutely against their will. Thus there is not the shadow of evidence to prove that the bankers are in any way inclined to modify their traditional views as to the functions of British banks and reconsider their position with regard to industry. The function of safeguarding the depositors' money by scrupulously keeping the assets in a liquid form was and still is the first consideration with British banks.[3] Mr. Thomas had declared in his Manchester speech that the banks were in agreement with him as regards long-term assistance of industries. But there does not appear to be any indication that they are equipping themselves for that task. In order to do that, without immobilising the funds held by them as deposits, substantial increases in their capital are necessary. But there is no sign as yet that the banks are considering a move in that direction. The fact that British banks have remained invulnerable in the recent crisis while

[1] See Mr. Pease's replies to the Chairman's questions.—*Committee on Finance and Industry, Minutes of Evidence*, Vol. I, p. 132.

[2] Evidence of Mr. M. Norman.—Committee on Finance and Industry, *Minutes of Evidence*, Vol, II, p. 295.

[3] *Cf.* "Our deposits are repayable on demand at short notice, our advances must be arranged on the same conditions. In making an advance we must be reasonably confident that the transaction will be self-liquidating in a comparatively short period or alternatively that the amount advanced will be forthcoming with reasonable promptitude in the event of a demand for repayment being made." (Speech of Mr. W. Tuke, *Chairman of the* Barclays Bank, January, 1936.)

banks in very few countries have been able to escape unscathed from its effects has tended to strengthen the position taken up by the British bankers. The history of foreign banking has been most unhappy during the years of the crisis. Misfortunes have overtaken a great many of them while not a tremor has shaken British banks, not a whisper of attack has been made against them.

The relations of the Bank of England with the S. M. T. and the B. I. D. must be carefully considered in this connection. The association of the country's Central Bank with industry through these subsidiaries has given rise to a good deal of discussion. It has been urged that it should never be the function of a Central Bank to associate itself with industry in any manner. But the relations have really been misunderstood. The authorities of the Bank made it clear to the Macmillan Committee that ordinarily it was never the duty of Central Banks to finance industry directly. But "desperate diseases," as Sir Ernest Harvey, the Deputy Governor of the Bank, aptly remarked, "require drastic remedies." [1] As regards the S.M.T., the Bank of England, owing to the abnormal conditions, came to be possessed of certain securities for particular purposes. This business was not a part of the Central Bank's normal duty and hence the S. M. T. was formed to take it over and conduct it in another building. It can be viewed only as a temporary or industrial adjunct of the Bank; it will not continue to be a permanent organisation. The B. I. D. also, as Mr. Montagu Norman, the Governor himself, put it, was an abnormal effort for an abnormal occasion—a step of an unusual character prompted for the general welfare of the country with a desire to give a helping hand, and absolutely unnecessary in normal times. The initiative was taken by the Bank as there was nobody else to take it and as a matter of fact the B. I. D. was not associated with the Bank in any real degree. [2]

[1] Evidence of Sir Ernest Musgrave Harvey, K.B.E.—Committee on Finance and Industry, *Minutes of Evidence*, Vol. I, p. 52.

[2] *Minutes of Evidence*, Committee on Finance and Industry, Vol. II, pp. 294-95.

The bankers are not only reluctant to relax their conservative codes of banking practice in regard to industry but also appear to believe that there is no gap in the financial system. The banking view is that industries generally do not find any difficulty in getting their money even for long-period purposes. Sound business propositions are seldom unable to obtain the assistance they require or desire. There is no need for providing a special mechanism for long-period industrial issues. The mechanism is already there and functions well—was the emphatic declaration of Sir Guy Granet before the Macmillan Committee. Mr. Montagu Norman also believes that industry depends on the issue house only for a fraction of its requirements. The mass of money in industry is really found through the brokers whose capacity for finding money is very big indeed. Existing agencies in the opinions of both of them are quite sufficient for normal times. Sir W. H. Goschen, Chairman of the National Provincial, also thinks that the existing facilities for long-period loans for British industries are not inadequate and even in the case of the smaller industries, if these are good propositions, opportunities for getting floatation facilities are not lacking. He believes that there are institutions in London which are prepared to lend to small industries. He does not agree that industry has ever been unjustifiably refused money that was necessary.[1]

But the industrial point of view is that though the banks' services have been reasonably satisfactory to industry according to their constitution and the conditions under which they operate, they are insufficient. There is a widespread feeling that it is necessary to call into being an additional specialised institution to assist industry with its requirements of finance of a character which the ordinary banks are unable to provide. There is a gap which has to be bridged. It is very difficult to obtain money for many useful enterprises through any of the existing agencies. A new channel is wanted—something in between the ordinary

[1] *Minutes of Evidence*, Committee on Finance and Industry, Vol. I, p. 122.

issue houses and ordinary banks—a means for providing the appropriate mechanism for long-period industrial issues. There was ample evidence before the Macmillan Committee to indicate that small and medium-sized industries laboured under great difficulties to raise this long-dated capital. Big public companies can obtain their required finance by a public issue but a small manufacturer engaged in a new type of industry is frequently handicapped for want of capital. Whenever he tries to raise money, he finds that his application receives no response from the lenders. They consider his particular business as untried and speculative and for that very reason are reluctant to risk their money in such enterprises. The requirements of the small and medium-sized industries are not considerable, they rarely exceed £10,000. A business proposition of £5,000, £10,000 or even £100,000 is not sufficiently attractive for the financial houses or investment trusts. Small propositions are turned down by the financial houses as they will not justify the expenses. The investment trusts are also not interested in them as they will have no free market and would require continuous and close watching. No banks will ordinarily lend such an amount involving a lock-up for more than a year. Hence the capital has generally to be placed privately. That is not only a lengthy business but has also unsatisfactory results.

But in the present conditions of the declining export trade of British primary industries, the smaller industries are precisely those to which all possible assistance should be extended. There is an evergrowing overseas market for their products. The Committee on Finance and Industry frankly recognised in their Report the difficulties confronting the small and medium industries and believed that there was really a gap in the financial machinery. They stressed the necessity of forming a special institution which would devote itself particularly to the smaller industrial and commercial issues and suggested the lines on which it might be evolved. [1]

[1] Report of the Committee on Finance and Industry, cmd. 3897 (1931), p. 174.

Ever since the Macmillan Committee drew attention to the existence of this gap and suggested the formation of a special company to devote itself to smaller commercial and industrial issues, their observations have been the subject-matter of prolonged discussion. There is a kind of widely held impression doubting the power of the City in the development of the country and the bankers for some time past have been endeavouring to remove that impression by initiating discussions among themselves in order to devise a new and satisfactory machinery for meeting the needs of the small and medium-sized industry. A number of ideas have already been put forward for carrying such a scheme into effect. The first hint was given by Mr. Beaumont Pease, Chairman of the Lloyds Bank, in the 75th ordinary general meeting of the shareholders held on February 4, 1933. He appreciated the need for such an institution and stated in the course of his address that steps for its formation were being taken. "I agree," said he, "that some organisation for providing finance for intermediate loans of moderate means and for comparatively short periods which would fill the gap between ordinary banking loans and those for a longer duration and for larger sums would be a desirable addition to our financial machinery. Steps for the formation of such an organisation should be and, I may say, are being taken."

Credit for Industry, Ltd. (1934):

Of the many schemes devoted in aid of the small industrialists, the one that has ultimately come to hold the field is the *Credit for Industry, Ltd.*[1] It was launched in March, 1934, under the aegis of the United Dominions Trust, of which the Bank of England had become the largest shareholder by the acquisition, in 1930, of 250,000 'B' shares of £1 each. The new Company has aroused the greatest interest inasmuch as it is the first

[1] I am indebted to Mr. A. C. Uren, Manager, Credit for Industry, Ltd., for some useful literature concerning the Company.

company of its kind, specializing in the provision of capital for plant and other purposes for the small and medium-sized businesses, which could not, by reason of their size, economically satisfy their requirements through the issuing houses.[1] The initial capital of £250,000 has been furnished by its sponsor the U. D. T. and will be increased from time to time as required. Additional finance will be raised by the Company's borrowings from banks and other sources and by the issues of debentures or short-dated securities. Its particular interest will be in the small and medium-sized industries but it will be prepared to provide credit for all types of industry. The financial facilities granted by the Company will be of a more permanent nature as distinct from the temporary accommodation of the banks. The maximum amount that can be advanced has been limited to £50,000 and will be for periods running from 2 to 20 years.[2] The loans will be repaid at an agreed rate over an agreed period. Though the loans will be for a fixed period, the borrower will have the right to repay the loan at any time within the period fixed. No loan will be made unless the borrower's bank is in general agreement that the loan will benefit the concern and unless also the bank at the same time is willing to continue its ordinary banking overdraft facilities according to the requirements of the business.[3] No loan will be granted merely for the purpose of repaying an old loan; nor will any assistance be given which will have the mere effect of increasing imports into the country. During the currency of the loan the assets of the borrowing concern will be charged by a simple charge or mortgage in favour of the "Credit for Industry, Ltd.," at least to

1 It was constituted with a strong Board of Directors with Mr. J. Gibson Garvice as Chairman. The other members were Mr. R. B. Pearson, Mr. C. Bruce Gardner (Director of the B. I. D. & Mang. Director, S. M. T.), Capt. C. E. Benson, D.S.O., and Mr. D. Carmichael, M.A., LL.B.

2 *The Economist*, Banking Supplement, May 12, 1934, p. 6.

3 "The Company has no intention of usurping the functions of the ordinary banks. The facilities to be granted are supplementary and complementary." (*Money for Industry*, a brief review of the functions of the C. F. I., Ltd., Regis House, London.)

the extent of the loan.[1] The annual interest on the loans for the time being will generally be from $4\frac{3}{4}\%$ to 6% *according to the circumstances* of the case. Apart from interest, there will be no extra charges except actual legal or other costs incurred in connection with the making of the loan. It will not participate in the profits of its borrowers nor will it accept, as any part of its reward, the issue of bonus shares. The Company will not finance new inventions or the acquisition of existing businesses. It is a lending rather than an investing institution. Its real purpose is to assist the further development of such enterprises as have already succeeded in building up a business to a certain *point and provide the finance to make the development possible.* Such concerns must have a satisfactory trading record for a number of years and must be at the time of assistance well-managed and in a sound financial position. A reasonable supervision will be exercised over the actions and methods of the borrowing enterprises but there will be no interference whatever and no attempt at control so long as a concern is being fairly well conducted.[2] The undertaking is in the nature of a very interesting experiment and its activities will be carefully followed in more than one country. Even the Chancellor of the Exchequer *observed in a recent speech that its further progress* would be watched "by us not only with sympathy but with earnest desire that it would succeed in filling what was undoubtedly a gap

[1] The security may take the form of a debenture in the case of a limited company or a mortgage on real or heritable property. Other types of security may also be considered.

[2] "The Company will not interfere with the control of any borrower's business except in the event of default on the part of a borrower or of his getting into financial difficulties. The Company's purpose is to provide finance—not to engage in industry. Loans will not be granted for the purpose of resuscitating derelict or bankrupt concerns. *It is not the function* of the Company to provide the money to start some one in business. Its purpose is to aid those already engaged in business who can show that they can improve their position with the help of additional liquid resources. The Company will not take shares in any borrowing concern." (See *Money for Industry*, *op. cit.*)

hitherto open in our credit system."[1] A large number of applications for financial assistance, ranging from a few hundred pounds up to the maximum amount the Company has been empowered to furnish, have already been received. They have come in sufficient volume to prove that there is a definite need for the kind of facilities the institution is designed to provide. It will really fill a very important need and is already assured of success. £77,000 of its initial capital had already been lent by June 30, 1934.[2] If the scheme is operated with vision and judgment and the ban on new inventions is not interpreted too rigidly so as to exclude new industries still in their early stages of development, it will surely prove to be of immense benefit to the small and medium-sized businesses.

[1] Speech of the Hon'ble Mr. Neville Chamberlain, then Chancellor of the Exchequer, at the Mansion House Dinner to the Bankers and Merchants of the City of London.—*The Statesman*, 19th October, 1934.

[2] The loans after repayments amounted to £210,523, £309,142 and £311,125, at the end of 30th June, 1935, 1936 and 1937 respectively. (See Reports and Accounts, U. D. T., 1935, 1936 and 1937.)

CHAPTER IV *

POST-WAR TRENDS IN COMMERCIAL BANKING PRACTICE AND THE RECENT REACTION

The orthodox theory of commercial banking is that commercial banks should confine themselves to short-term self-liquidating transactions. Their liabilities are demand liabilities. It is never safe for them to operate with demand liabilities on the one hand and slow non-liquid assets on the other. Their assets should, therefore, consist for the most part of cash or what is readily convertible into cash. The most easily convertible asset and hence the soundest type of investment for a commercial bank is the trade discount or commercial bill. It possesses a degree of liquidity far greater than other types of bank loans. Commercial bank loans are largely based upon goods in process of production and the expectation is that as the goods move to a further stage of production, they will in the normal economic process be sold and thus permit the repayment of the loans. The essential function of the commercial bank in relation to industry consists in the furnishing of circulating or working capital as distinguished from permanent capital. The making of loans for this purpose helps in the onward march of commodities from the producer to the final consumer. The commercial bank takes its name as it thus assists in the financing of commerce as distinct from the permanent assets which are necessary for the carrying on of commerce. The commercial banking institutions mainly devote themselves to what has been described as "deposit banking," they receive money on deposit and lend it on short-term to commerce and industry.

* The substance of this chapter was published in the form of an article in the *Indian Journal of Economics*, July, 1932 (Revised and re-written).

in the shape of discount and advances. They are normally unwilling to lock up their funds in long-term credits to or participations in industrial enterprises. The investment banking function consists, on the other hand, in the raising and redistribution of fixed capital. It is carried on mainly through the purchase of shares and debentures of joint-stock companies and their subsequent sale at a profit to investors.[1]

In the pre-war days the segregation of commercial and investment banking into entirely separate circles was absolute and reached its perfection in England. It was also practically complete in France and the United States. In the years after the War the lines of distinction between commercial and investment banking grew shadowy and indistinct. There was no longer that pronounced cleavage between the two types of institutions as regards their policy and practice. The activities of the one began to shade gradually into those of the other. There was noticeable a remarkable trend among commercial banks during the post-war years to adopt the manner and practice of investment banks. They entered into much closer relations with industry than ever before. We have already noticed that a change was rapidly taking place in the Continent of Europe, specially in Germany, where the fusion between investment and commercial banking was practically complete. The German banks tended to depart more and more from the pre-war practice of combining the functions of commercial with those of investment banking in all its aspects. Deposit banking which was formerly overshadowed by the importance of investment banking and long-term transactions began to receive increasing attention from the big banks. Their holdings of securities and participations had been considerably reduced not only in proportions to total assets but in many cases even in absolute amounts since before the War. The proportion of capital and reserves to liabilities had declined to a great extent and was similar to that

[1] Parker Willis and J. I. Bogen, *Investment Banking*, p. 5.

customary in England and the United States. The banks there appeared to have grown keenly alive to the grave risks involved in the immobilization of their funds in long-term loans to industry and they had considerably modified their methods for long-term industrial financing.[1] They were approximating more and more closely to the pre-war English banks, the purest example of deposit banking. While the "mixed" banks of Germany were gradually approximating to pure commercial banks by shedding their investment trust activities, the commercial banks elsewhere showed remarkable trends to develop into mixed banking institutions by combining with their legitimate business investment banking to an increasing extent.

We have said that the segregation between commercial and investment banking in the pre-war years was absolute. By "absolute," we are not suggesting for a moment that it was always easy to draw a hard and fast line of demarcation between commercial and investment banking. It was often found that in practice any particular institution carried on, in addition to its basic functions, some banking functions which did not strictly belong to it. But generally speaking, the functions were never mixed up and integrated. A commercial bank or an investment bank kept itself mainly confined to its own legitimate functions. In the post-war years there was a general shift of the interests of commercial banks in favour of industrial banking. This drift in their practices, noticeable even before the War, was accentuated in the years that followed it.

The status of the commercial bank, long defined as an institution of discount, deposit and exchange, was profoundly modified in post-war years. It may be recalled that even in England, which is the great citadel of pure commercial banking theory, the

1 Memorandum on Commercial Banks (1913-29), League of Nations, Geneva, 1931, p. 14. See also H. Powys Greenwood, "Transition Period in Germany—Recent Developments"—an article in the *Times, Trade and Engineering Supplement*, Banking Number, June 29, 1929, p. 25.

joint-stock banks, though involuntarily, relaxed in many cases their traditional attitude of aloofness from industry. The relaxation in the strict codes of commercial banking theory was considerably greater and, what is more, became a part of the deliberate and considered policy of deposit banks elsewhere. Commercial bills had since the War been declining in importance as a method of investment with commercial banks, while there was a surprising increase in the growth and importance of the business of long-term industrial financing and all those activities which are known as "investment banking." This reflected a fundamental change in the nature of commercial banks and their methods of financing industry. Instead of the usual task of providing working capital only to industry through the discount of commercial paper, they contributed also towards its fixed capital expenditure in a manner they had never done before. There were three principal methods by which they were furnishing this long-term industrial finance. To the extent that they made direct investments in shares and bonds of joint-stock companies, they were obviously contributing fixed capital to industrial enterprises. Loans to purchase securities which were then pledged to secure the loans were practically "vicarious purchases of securities," and were, therefore, also advances for permanent capital purposes. Lastly, real estate loans involve a lock-up of resources and are truly a characteristic feature of investment banking. The undertaking of such business by the commercial banks must mean a definite departure from their traditional sphere of business. There was a pronounced tendency on the part of commercial banks to devote a considerable amount of their resources not only to direct investments and loans on security but also to real estate loans.

It will not be possible to examine separately and in detail the recent evolution in commercial banking in each country in the space available. It is proposed here to select a few representative countries, where the separation between commercial and investment banking was practically complete before the War and stress

the main trends in commercial banking practice during the decade 1920-30 and their reversion in more recent years.

The United States of America

Before 1837, the commercial banks in the United States were often found to exercise some of the functions of investment banking. But the panic of 1837 and subsequent losses incurred by the banks as a result of dealing in securities made them recognise the difference between banking with liquid and non-liquid assets. Ever since that period until the outbreak of the Great War, the business of commercial and that of investment banking were in the hands of separate institutions.[1] The investment houses, the investment trusts and savings banks, mutual and stock, were institutions primarily engaged in pure investment banking business. The basic functions of commercial banking were, on the other hand, exercised by the national banks. In line with the theory that the national banks were commercial banks *par excellence*, severe restrictions were imposed upon them by the National Bank Act. These restrictions referred chiefly to the maximum amount loanable to a single borrower, real estate loans, dealing in investment securities, receipts of savings bank deposits, etc. The State banks, though modelled on lines adopted in the National Bank Act, were subject to less severe restrictions. State bank laws generally permitted mortgage loans and in some cases no limits were imposed on advances against real estate security.

1. Real Estate Loans.

Although the national banks were put under legislative restrictions, yet long before the War they could be seen drifting towards investment banking functions. The laws before 1913 prohibited national banks to lend on the security of real estate or to acquire real estate other than business premises except in

[1] Parker Willis and J. I. Bogen, *Investment Banking*, p. 165.

settlement of a debt already contracted. Property so acquired had to be disposed of within five years. But in the farming regions a large proportion of the advances made by the country banks had already become long-term loans secured by land. An important step towards the mixture of banking functions was taken when the provisions of the Federal Reserve Act subsequently allowed national banks to accept savings deposits and granted a limited permission to make mortgage loans. The F. R. Act for the first time recognised the distinction between time and demand deposits and laid down the requirement of a reserve of 3% (originally 5%) for time deposits as against 7%, 10% and 13% for demand deposits, the ratio depending on where they were located. As regards real estate loans, national banks other than Central Reserve City banks were permitted to make five-year loans on the security of improved farm land in the same federal reserve district or not more than 100 miles distant from the lending bank irrespective of district lines. One-year loans on city realty were also authorised. These loans were limited to 50% of the value of the property and could be made up to one-quarter of the lending bank's capital and reserve funds or one-third of its time deposits.

There was a remarkable growth of real estate loans in the business of American commercial banks during the post-war years. They accounted for the greatest relative increase in the credits outstanding of all commercial banks between 1922-29. They increased by 128%, while security loans rose by 77%, investment by 43%, and all other loans by only 22%. The following table strikingly illustrates this enormous percentage increase of real estate loans during the period under review [1]:—

All Commercial Banks (1922-29) (000,000 $ omitted)

		30th June, 1922.	30th June, 1929.	Percentage increase.
Real Estate loans	...	1,989	4,510	128
Security loans	...	6,521	11,518	77
All other loans	...	15,101	18,367	22
Investments	...	9,215	13,191	43

[1] Memorandum on Commercial Banks (1925-33), League of Nations, 1934, p. 237.

The majority of these real estate loans made by American commercial banks was against urban real property. With the onset of the economic crisis, the bulk of these loans became " frozen " and it is feared that a million dollars had to be written off on these transactions.[1]

2. Loans on Security.

The tendency of American banks to go in for investment banking is manifested further in the rapid growth of security loans during the post-war years. Commercial bank loans on securities in the United States rose from 5,780 million dollars in 1922 representing 24·4% of the total loans to a peak of 130,026 millions in 1930 representing 38·6 of the total. All other loans rose from 15,352 million to 15,700 million dollars only during the same period.[2] Although real estate loans showed the greatest percentage increase, security loans accounted for the greatest absolute increase in the credits outstanding between 1922 and 1929.

3. Investments.

The entry of the American commercial banks into investment banking business is also evident from the enormous growth of investments in the post-war years. Although the national banks were prohibited from doing business in investment securities, bond investments by banks had been accomplished as far back as 1900 without any special legal sanction. The corporate powers of the national banks permitted them " to discount and negotiate promissory notes, drafts, bills of exchange and other evidences of debt." This became the banks' authority for dealing in investment securities and under it, with the approval of the Comptroller of Currency, they created their bond departments. Their authority for the creation of the bond departments was, however, somewhat doubtful and their establishment was sanctioned by the Comptroller because the law empowered them to deal in other evidences of indebtedness.

1 R. W. Goldschmidt, *The Changing Structure of American Banking*, p. 81.

2 Based on data published in the Annual Reports of the Comptroller of Currency.

The American banks have always invested a considerable portion of their resources in securities and the movement may be traced to the years before the War and even to the last quarter of the nineteenth century. But in the period under review there was a remarkable tendency in this direction. In 1875 the loans and discounts of national banks were about twenty times as large as their investments; in 1914 they were only six times and in 1929 less than two and a half times as great. During 1914-1929, however, investments were found to have increased by 500% while loans and discounts increased less than half as rapidly. The banks not only held these securities as permanent investments but also endeavoured to place them with their clients.[1]

The securities which compose the investment portfolio of the banks may broadly be divided into Government and Municipal, and into those that are not so. The figures given below strikingly illustrate a definite upward trend for "other security" holdings of national banks from 1922 to 1928 (expanding from $1,863 millions to $3,416 millions)[2] :—

National Banks

INVESTMENTS
(In millions of Dollars)

	Total	U. S. Govt. and State and Municipal	All others (Railroad and Public Utilities and Bonds, Shares, etc.)
1914	1,921	975	946
1922	4,563	2,700	1,863
1923	5,070	3,096	1,974
1924	5,142	2,987	2,155
1925	5,730	3,131	2,599
1926	5,842	3.117	2.725
1927	6,393	3,340	3,053
1928	7,147	3,731	3,416

The tendency towards a mixture of banking functions which had been working for a long time was thus considerably

[1] Memorandum on Commercial Banks (1913-29), League of Nations, p. 329.

[2] Memorandum on Commercial Banks (1925-33), League of Nations, 1934, p. 335.

accentuated in the post-war years. Indeed American banking law seems to have given official sanction to this investment policy of the commercial banks.

The Federal Reserve Act, it will be recalled, had considerably broadened their investment banking functions. Later legislation permitted a yet greater fusion of banking functions. The McFadden Banking Act, which received the approval of President Coolidge on February 5, 1927, was a distinct forward step. The Act set the seal of the legislature's approval upon the investment functions of the commercial banks. It specially recognised that dealing in investment securities was a perfectly legitimate business of the modern commercial banks and authorised the national banks to engage in that type of transaction. The Act provided that " the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, co-partnership, association or corporation in the form of bonds, notes and (or) debentures commonly known as investment securities."[1] The maximum amount which might be held of the securities of any one obliger or maker was limited to be 25% of the banks' paid-up capital and reserve. Thus the Act expressly allowed the banks to enter the business of security issue and distribution.[2] Stocks are not evidences of indebtedness and, as before, the banks were not permitted to purchase them for their own account.

The Act not only specially recognised the legitimacy of dealing in bonds, but also considerably removed the restrictions on the grant of real estate mortgage loans. Such loans had always been frowned upon by commercial bankers as a non-liquid asset. The Federal Reserve Act had granted a limited permission in this respect. The McFadden Act recognised that it was not sufficient and authorised the national banks to make

[1] Sec. 2(b), The McFadden Banking Act, 1927.

[2] " The McFadden Banking Act of 1927 "—an article by H. H. Preston in the *American Economic Review*, Vol. 17, June, 1927.

real estate mortgage loans on a far larger scale. They were now permitted to loan on city realty for a period of five years against one year formerly. Not only the period of the loan was extended but the limit to which the total volume of such loans had been subjected was raised liberally. Banks were permitted to place 50% of their savings deposits in mortgage loans as against 33⅓% of their time deposits formerly, the limit as to a quarter of the capital and reserves remaining as before. Although this provision implied that that portion of the time deposits which was not strictly savings deposits could not be invested in real estate mortgages, yet the final effect of this section of the Act was to increase materially the total funds that national banks might now lend on the security of real estate.[1] The ban which was formerly placed on the banks in Central Reserve Cities as regards engagement in such type of business was removed altogether.

After the passing of the McFadden Act of 1927, thanks to its liberal provisions, the banks entered into the investment field to a far greater extent. There was soon afterwards a tremendous outburst of speculative activities among them. Their commitments in the stock market during 1928-1930 were extremely heavy and many of them became deeply entangled in real estate and security loans. The statistics published by the *Federal Reserve Bulletins* disclose a remarkable growth of direct investments and loans against security during this period.

Reporting Member Banks[2]
(In millions of Dollars)

	Loans on Securities	All other
December, 1928	7,198	9,055
December, 1929	7,968	9,476
September, 1930	8,890	8,469
December, 1930	7,776	8,557
September, 1931	6,413	7,870

[1] R. G. Rodkey, *The Banking Process*, p. 256. Dr. Rodkey has shown by an interesting calculation that, taking the figures for 30th June, 1926, the new Act permitted an increase of $514,766,000 for investment in real estate mortgages.

[2] *Federal Reserve Bulletin*, Vol. XVI, 1930, p. 12, p. 773. Also *Fed. Res. Bulletins*, 1931 (Feb. and Oct.), p. 65, p. 563.

Reporting Member Banks

(In millions of Dollars)

INVESTMENTS

December, 1928	...	5,936	
December, 1929	...	5,567	
September, 1930	...	6,361	
December, 1930	...	6,784	
September, 1931	...	7,795	U. S. Govt. 4,154; Other 3,641

Loans on securities of reporting member banks reached their peak in September, 1930. Between April, 1927 and September, 1930, security loans rose from $5,924 millions to $8,390 millions, representing an increase of 41·6%, while all other loans fell from $8,612 to $8,469 millions. Compared with January, 1922, security loans increased by about 133% while all other loans increased by only 13·5%.

The tables given above amply demonstrate that the assets of the American banks were generally more illiquid and of a more speculative character in 1929 than in 1922; the extreme point was reached in 1930. One fact of startling importance that at once leaps to the eye is the declining importance of the "all other loans," which mostly represent self-liquidating commercial transactions. It is also interesting to note that not only they diminished in importance but their average quality also deteriorated. For example, in the case of all national banks, the importance of commercial loans eligible for rediscount at the Federal Reserve Banks dropped from 42% in 1922 to 38% in 1929.[1]

From September, 1930, the banks, sorely battered by the financial storm of 1929, began to set their houses in order and

[1] Memorandum on Commercial Banks (1925-1933), League of Nations, Geneva, 1934, p. 238.

within a short time considerable progress was made in the direction of liquidation of frozen assets. Loans on securities in September, 1931, in the case of the Reporting Member Banks, amounted to a little more than $6,400 millions and represented a big drop from high point reached in the same months of the previous year. Investments no doubt increased and they were higher than in 1930 but the investment portfolio was much more liquid than before. It contained a large element of short-term Government securities.[1] As will be seen from the table given below, in the case of national banks all other investments decreased in 1932 while Government and Municipal investments showed an increase:—

INVESTMENTS (in millions of Dollars) [2]

30th June	Total	Govt. and Municipal Bonds	All other Bonds and Shares
1927	6,393	3,340	3,053
1928	7,147	3,732	3,415
1929	6,656	3,561	3,093
1930	6,888	3,546	3,342
1931	7,675	4,253	3,422
1932	7,197	4,584	2,613

The astounding increase in the growth and importance of direct investments in non-Government securities and loans on security during 1922-1930 reflected a fundamental change in the character of the American commercial banks. They were no longer concerned with the provision of short-term funds for working capital purposes to industry but were also deeply interested in furnishing long-term industrial finance.[3]

[1] *The Economist, Banking Supplement*, Oct., 1931, p. 9.

[2] Based on the data published in the Annual Reports of the Comptroller of Currency.

[3] Memorandum on Commercial Banks (1925-33), League of Nations, Geneva, 1934, p. 238.

4. Security Affiliates.

The organisation of security affiliates by the American commercial banks is perhaps the strongest evidence of their increasing investment banking activities. The rise of these affiliates overshadowed in importance every other development of American banking in recent years. The origin of the device of security affiliates may be traced back to 1903 when the First National Bank of New York organised the first securities company (The First National Company) because of the pressure exerted by the Comptroller of Currency owing to the obvious conflict between deposit banking and the business of marketing securities. Three years later, the National City Co. was established by the National City Bank. These two subsidiaries remained solitary for a number of years. But as the commercial banks felt more and more inclined to enter into the field of investment banking, the organisation of security affiliates proceeded apace. Thus when the War Loan campaign brought the commercial banks in the country into close contact with the business of distribution of securities, the number of security affiliates began to increase rapidly. The Chase Securities Corporation was organised in 1917 by the Chase National Bank and affiliates were formed in quick succession by the First National Bank of Preston in 1918, the Guaranty Trust Company and the Hibernia National Bank (New Orleans) in 1919 and the Central Illinois Bank in Chicago in 1920. The participation of the commercial banks in investment banking became more direct and intense since the close of the year 1927. The movement of organising security affiliates for the purpose of undertaking investment banking business spread like wild fire from that time among commercial banks.[1] As a result almost every large urban commercial bank in the U.S.A. became equipped with one or more security affiliates. By 1931 national banks alone could boast of nearly 200 of them. The business of

[1] R. W. Goldschmidt, *The Changing Structure of American Banking*, p. 184.

banking necessarily underwent a radical transformation indicating the decline of commercial banking proper and the increase of investment banking.

The " security affiliates " were created by the large city banks, excluded as they were from issue and financing business by legislation, to carry out the type of transaction from which they were debarred. The issues in which the banks were interested were made through these subsidiary companies. The affiliates were incorporated separately, the capital being subscribed either directly by the parent bank or by its shareholders. In many cases the stocks of the affiliate were automatically paid for out of a special dividend to bank shareholders. In the case of the first securities company, the parent bank (the First National Bank) had provided the capital out of its own surplus. An analysis of the methods of incorporation of national banks' affiliates in recent years discloses four methods of control: (*a*) stock owned by the parent bank, (*b*) stock owned by the bank shareholders, (*c*) stock owned by other affiliates, (*d*) stock trusted.[1] Thus in 1931 out of the 192 affiliates of the national banks, the parent banks directly owned four only; in 17 cases the affiliates' stock was owned by another affiliate of the parent bank; in 45 cases it was distributed in the form of joint and indivisible certificates of shares in the bank and security company among the parent bank's shareholders. As a rule, however (126 cases), the capital stock of the investment affiliate was held by a body of trustees for the benefit of all the shareholders of the parent bank.[2] The affiliates were usully the recipients of heavy loans from their parent banks which enabled them to engage in transactions not permitted to the latter. There was until recently scarcely any restriction on the national banks' loans to their affiliates, the only limitation being the

[1] "The Banking Act of 1933"—an article by R. B. Westerfield, in the *Journal of Political Economy*, December, 1933, p. 738.

[2] R. W. Goldschmidt, *The Changing Structure of American Banking*, p. 185.

provision that loans to no single interest should exceed 10 per cent. of the banks' capital and reserve fund.

The affiliates performed a variety of functions. Three of these might be said to comprise an intrinsic part of their activity as investment bankers. They were :—

1. Origination of new security issues.

2. Formation of or participation in the original selling group, disposing of the securities in large blocks to retailing bankers all over the country or occasionally to institutional buyers.

3. Distribution of bonds and to a lesser extent of shares to the ultimate investor.

As regards the underwriting and distribution of securities they acted both as wholesalers and retailers, purchasing entire or part offerings and distributing the securities through salesmen to private investors and institutions.

"In addition they sometimes acted as holding companies for control or other purposes, carrying securities which the parent bank was not authorised or did not wish to have among its investments; as investment trusts, buying and selling securities for investment or speculative purposes ; as assets realisation companies taking over the parent bank's loans and investments which proved doubtful or illiquid ; as real estate holding companies and as a medium for supplying the bank's own stock." [1] These security subsidiaries worked closely together with their parent concerns so that the net effect was somewhat similar to that of the German system.

Thus the commercial banks which had already created the bond departments entered into the stock market to a considerable extent through these affiliates. The development of the affiliates rapidly increased the banks' share in the total flotations of new securities. In the pre-war years a very small proportion of the total distribution of securities was made through the commercial

[1] Memorandum on Commercial Banks (1925-33), League of Nations, Geneva 1934, p. 240.

banks, but in 1931, 54·4% of all new securities was sponsored by the bank affiliates, those of the national banks alone accounting for 33·6%[1] In the years immediately before the onset of the economic crisis, there was a tremendous outburst of speculative activity among the investment affiliates. The banks rushed recklessly into the stock market through their affiliates; and the inevitable crash soon occurred. The country became littered with a crop of bank failures. No less than 1,345 banks closed their doors in 1930.[2] This was undoubtedly a very large number even in the case of a country where banking suspensions are a normal phenomenon in times of prosperity. Conditions have come to light in connection with these bank failures which clearly reveal the abandonment of pure commercial banking and the integration of financial operations of a diverse character. The recent banking investigation has thrown a flood of light on this drift of American banks into the unwonted channels of investment banking. The enquiry disclosed that there was an almost universal tendency towards "a speculative security basis for banking"[3] and practically every one of the large commercial banks was found to possess security affiliates. In many instances a single bank owned a considerable number of affiliates—the Bank of the United States having as many as 48 affiliates.[4]

FRANCE

The tendency towards an intermixture of banking functions was also at work in post-war France. In contrast to the system prevalent in Germany and other countries of Europe, French

[1] "The Banking Act of 1933"—an article by H. B. Westerfield, in the *Journal of Political Economy*, December, 1933, p. 739.

[2] *The Statist, International Banking Section*, November 14, 1931, p. 662.

[3] "Speculative Activities of American Bankers"—an article by H. P. Willis in the *Banker*, February, 1931, pp. 188-92.

[4] "The Senate Banking Investigation"—an article by H. P. Willis in the *Banker*, March, 1931, p. 325.

banking, before the War, was characterised by a division into two distinct classes, *viz.*, the banques d' affaires and the banques de depôts. The former type specialised in the long-term financing of industries and in the origination of securities. These institutions acted as investment bankers in the full sense of the term. They often participated to a substantial extent in the management of the industries promoted by them and used to carry the purchased securities in their portfolios for considerable periods of time until the success of the enterprises or market conditions allowed their sale to the public at reasonable prices. These purely investment institutions, however, often undertook other functions such as the opening of current accounts to their industrial customers. They had to do so as they could not depend solely upon their own business which was naturally of an irregular type. But generally it may be said that they performed the basic functions of investment banking. Among the most important of the banques d'affaires were the Banque de Paris et des Pays-Bas, the Banque de l'Union Parisienne, the Banque Francaise Pour le Commerce et l'Industrie and the Credit Mobilier Francaise. These financial banks specialised in the issue business and in the flotation of industrial and financial enterprises all over the country and even abroad.[1] In the case of the other type of

[1] Thus the Banque de l'Union Parisienne has been associated with electrical and metallurgical works and it has considerable interests in the Creusot Works of MM. Schneider et Cie. Before the War, it took an important part in the development of Russian metallurgy; and since the end of the War it has taken an active part in financing economic development in Central and Eastern Europe either directly or through the Union Europeenne Industrielle et Financiere. In recent years it has participated very actively in new issue business and has largely increased its portfolio of investments in other undertakings. Its investments and participations have been as follows :—

1928	1929	1930	1931
Frs.	Frs.	Frs.	Frs.
229,459,704	327,276,458	366,465,485	439,202,694

The Statist, Int. Banking Sec., Nov. 14, 1931, p. 724. Also Nov. 12, 1932, pp. 693-94.

In May, 1932, the Bank took over the Credit Mobilier Francaise.—*The Statist, Int. Banking Sec.*, Nov. 12, 1932.

institutions, the etablissements de credit, there was before the War a marked unwillingness on their part to advance funds freely for the development of domestic industries. Instead, they concentrated on the foreign securities business, putting out numerous foreign state and industrial loans in succession. They were, indeed, accused of neglecting domestic industry and of diverting French savings to countries like Russia, South America, Turkey, etc.[1]

The division, even before the War, could not be made too absolute. There were many institutions which were frankly "mixed." The lines of demarcation between the two types grew more and more indistinct after the Great War and almost faded away in later years. The whole system underwent a considerable change since the pre-war period. The banques d' affaires which specialised in financial business formerly began to develop, not without success, the ordinary transactions, properly speaking, of a bank. There arose a definite tendency on their part to adopt a more and more aggressive policy of commercial banking. The credit banks, on the other hand, entered the investment field in a manner they had never done before.[2] During the War the Government had obtained control of the investment operations and had passed a law on May 31, 1916, forbidding the issue of foreign securities in the French market. The credit banks with the practical cessation of the foreign loan business occupied themselves with State issues and the finance of national industry. From that period, they came to extend much more financial assistance to domestic industries than they had ever done before. In the years that immediately followed the War, French industry became badly in need of credit on a large scale. War liabilities had to be liquidated, factories destroyed in the devastated regions had to be re-built, industries engaged directly or indirectly in the reconstruction of the devastated areas had to

[1] Parker Willis and B. H. Beckhart, *Foreign Banking Systems*, p. 572.

[2] *The Times Trade and Engineering Supplement*, Banking Number, June 29, 1929. p. 24.

be equipped with new installations. The French credit banks were not unresponsive in this hour of need. As Mr. Whale has observed, " The increased importance of French industry called for adaptations in banking policy." [1]

The banks were quick to realise the need to provide more extensive assistance for their industrial customers. When the industries approached them for extended credits, they readily lent their collaboration and helped to float new issues of bonds and shares. The banks could not " lock-up " in long-term loans the funds lent to them on deposit accounts. But they had to create the desired facilities for long- and medium-term credits for the pressing requirements of their industrial clients. Wherever possible, they helped directly with the funds which were deposited with them for fixed periods and also with their own resources which they had already begun to increase. The policy of systematically increasing their paid-up capital and reserves which they pursued during the period under review lends colour to the view that their character was changing rapidly. The tables given below strikingly illustrate a marked increase of capital and reserves in the case of the principal deposit banks of France :—

TABLE I

(Five, since 1931 Six)

In millions of francs

	1925	1929	1930	1931	1932
Paid-up Capital. ...	1,156	1,643	1,701	1,383	1,490
Reserves. ...	561	1,897	2,038	1,884	1,897

1 P. B. Whale, "Lectures on English and Continental Banking" (delivered March 26, 1931), *Journal of the Institute of Bankers*, June, 1931, p. 390.

2 Memorandum on Commercial Banks (1925-33). League of Nations, Geneva, 1934, p. 101.

TABLE II[1]

(Individually)

In millions of francs

		1927	1928	1929	1930
1. Banque Nationale de Credit:					
Paid-up Capital.	...	250	262½	262½	318¾
Reserve	...	120	136	123	175
2. Comptoir National d' Escompte:					
Paid-up Capital.	...	250	250	400	400
Reserve	...	131	144	448	452
3. Credit Lyonnais:					
Paid-up Capital	...	255	255	408	408
Reserve	...	227	227	800	800
4. Societe Generale:					
Paid-up Capital	...	250	250	319	320
Reserve	...	75	105	306	389

The French deposit banks helped the industries in yet another way. In order to provide greater assistance to them without immobilizing the funds entrusted to them on deposit, they formed subsidiary companies for long-term industrial finance. Thus two of the old established and powerful institutions, the Credit Lyonnais and the Comptoir National d' Escompte, created, as far back as 1919, the Union pour le credit a l'Industrie Nationale (Ucina). With the same purpose the Société Generale founded in 1928 the Societe Anonyme de credit a l'Industrie Francaise, and the Credit du Nord established a similar company, the Union Bancaire du Nord.[2]

The reports of the six main deposit banks of France for 1927 and 1928 give clear indication of the increasing interest

[1] *The Statist, International Banking Section.*

[2] P. B. Whale, " Lectures on English and Continental Banking " (delivered March 26, 1931), *Journal of the Institute of Bankers*, June 1931, p 399.

they were taking in industrial finance, not only by lending collaboration to the issues of short- and long-term bonds of French industry but also by becoming large holders in industrial undertakings. As in Germany, they were taking shares in preliminary enterprise and the Syndicate d'etude was seldom without banking representation.[1] Their balance sheets show that their investments in financial syndicates increased considerably during 1913-28 :—

(In Millions of Francs)

1913	1919	1927	1928
158	200	246	267

JAPAN

Although Japan possesses a special Industrial Bank, the ordinary commercial banks in the country are found to have increased their activities in the sphere of industrial financing during the period under review. There was a persistent tendency on their part to accommodate industries with extensive loans. The practice of locking up their funds in long-period loans on securities and immovable property was quite common. Mr. Allen estimates that the advances of ordinary and savings banks on immovable property were more than 1,000 million yen in 1921.[2] Dr. S. Furuya in a recent work points out that the so-called exchange banks of Japan are not strictly speaking exchange banks at all and they very often entangle themselves in heavy long-term investments in industries.[3] In more recent times, especially after the crisis of 1927, the ordinary banks entered into the stock market on a very large scale. Their tendency for security holdings considerably increased. Formerly they used to compete with one another

[1] *The Times Trade and Engineering Supplement*, Banking No., June 30, 1928, p. 15.

[2] G. C. Allen, *Modern Japan and its Problems* (1928), p. 179.

[3] Dr. S. Y. Furuya, *Japan's Foreign Exchange and her Balance of Intrenational Payments*, p. 162.

in attracting deposits; now they were competing keenly in the business of underwriting debentures. The balance sheets of four out of the "Big Five" disclose a remarkable increase of their security holdings in recent years.[1]

TABLE I

Securities held by Four of the "Big Five"

(In thousands of Yen)

		1927	1928	1929	1930	1931
1.	Mitsubishi	233	322	360	337	285 (Dec. 31)
2.	Mitsui	...	221	233	215	272 (June 30)
3.	Sumitomo	174	236	233	242	248 (Dec. 31)
4.	Dai-ichi	...	248	285	269	304 (June 30)

TABLE II

		Dec. 31, 1932	Dec. 31, 1933	June 30, 1934
1.	Mitsubishi	305	345	411
2.	Mitsui	182 (June)	280 (June)	353 (June)
3.	Sumitomo	261 (Dec.)	326 (June)	358 (June)
4.	Dai-ichi	...	376 (June)	408 (June)

The returns of the clearing house banks in Japan also reveal that they were employing a considerable portion of their surplus funds in investment in securities.[2] During the industrial crisis in the autumn of 1930, following the lead of the Industrial Bank of Japan, the Tokyo commercial banks generously lent their assistance to several big industrial companies in distress for want of funds. An understanding was reached between them for joint

[1] *The Statist, International Banking Section*, Nov. 14, 1931, pp. 761-65. Also Nov. 12, 1932, pp. 781-84.

[2] *The Times Trade and Engineering Supplement*, Banking No., June, 28, 1930, p. 25.

action in giving financial aid to business enterprises. A new machinery was set up for this purpose. The banks and trust companies formed an association, called the Industrial Investigation Association, with the object of facilitating the rationalisation of Japanese industries. It investigated the conditions of several concerns to find out if they required reorganisation and if financial assistance to them was justified.[1]

Canada

The same tendency of sponsoring industrial securities and of generally invading the field of investment banking is discernible in the case of the commercial banks of Canada in post-war years. They were devoting themselves to an increasing extent to underwriting operations and figures have been collected which show that their participations in the flotation of bond issues totalled during 1927-32 more than 250 million dollars.[2] The investment houses naturally came to look with great disfavour upon this extension of commercial banking activities into their legitimate sphere of business and they filed with the recent Canadian Banking Commission a memorandum complaining that they were suffering severely from the competition of the ordinary banks and also requesting that this aspect of their activities should be checked when the Bank Act was revised. It was suggested that "the Banks should be prohibited by statute from selling securities directly to the public and also from tendering for new issues either individually or as members of syndicates and from acting as agents in connection with issues made by Governments, Municipalities and other public bodies."[3] The banks on their part contended that dealing in securities was a recognised normal activity of banks throughout the world and

[1] *The Times Trade and Engineering Supplement*, Banking Number, June 27, 1931, p. 27.

[2] See *The Economist, Banking Supplement*, October 14, 1933, p. 13 ("The Banking Situation in Canada").

[3] *Report of the Royal Commission on Banking and Currency in Canada*, Ottawa, 1933, p. 76.

had been established in Canada as far back as 1876. The Bank Act of 1890 and subsequent revisions had conferred upon them the right " to deal in and discount and lend money and make advances upon the security of and take as collateral security for any loan made by it, bills of exchange, promissory notes and other negotiable securities or the stock bonds, debentures and obligations of municipal and other corporations whether secured by mortgage or otherwise." The Royal Commission was impressed by evidences of considerable laxity and abuses of commercial banking practice and concluded that although the volume of industrial securities " sponsored and distributed by the banks might have been small in comparison with that of Government and other securities, yet it was advisable that the banks should refrain from dealing in or distributing for their own account any but the highest class securities."[1]

Reasons for the Landslide in Commercial Banking Practice :

It is abundantly clear from the foregoing study that there was a historic landslide in commercial banking practice. The countries which had been so long traditional homes of commercial banking departed to a surprising extent from its recognised canons. Their banks in many instances tended to adopt business at much of which bankers would have shuddered in the pre-war days. There was a decisive shift of their interests in favour of industrial banking ; they became frankly " mixed."

The reasons for this remarkable fusion of banking functions in countries where they were so carefully segregated are not far to seek. The relaxation in the conservative codes of commercial banking practice was partly the result of the post-war depression and partly the result of changes in general economic organisation. A widespread slump followed in the wake of the Great War. The incidence of the depression upon several

[1] *Report of the Royal Commission on Banking and Currency in Canada*, Ottawa, 1933, p. 77.

industries was extremely severe. A considerable portion of the advances of commercial banks to such industries became practically "frozen" and unrealisable. To protect their own interests the banks were obliged to make further advances and also to take over the security for the loans previously granted and to assume direct control over industrial enterprises. Recent economic changes lying entirely outside the banking system have also compelled the commercial banks to depart from their traditional practices. Owing to the progressive concentration of industry, the small firms are tending to disappear and business units are fast growing in size. The smaller concerns were the principal users of the commercial banks and, with their disappearance, the demand for commercial bills has rapidly declined. Access to the capital market is comparatively easy for the larger concerns and these in the post-war years have shown a remarkable tendency to develop the practice of obtaining working capital in the investment market by issuing to the public long- and short-term notes as well as stocks. This tendency has been mostly manifest among American industrial companies where they have been, for some years past, particularly since 1927, endeavouring to meet their working capital requirements not by borrowing from the commercial banks but through the long-term capital market or through the retention in liquid form of earnings in the business.[1]

The effect on the banks was twofold. They found that their funds had been accumulating in large amounts while the principal channel of putting them through was fast disappearing. The deposits had been swelling to an enormous size but the growing funds were not needed by commerce. They found it well-nigh impossible to utilise their funds in the ordinary transactions of commercial banking. Under the circumstances, they were compelled to explore other than the time-honoured traditional avenues for the employment of their funds. If they were

[1] "Social Aspects of Commercial Banking Theory"—an article by F. A. Bradford in the *American Economic Review*, June, 1933, p. 231.

See also Rodkey, *The Banking Process*.

to make profits, nay, to exist at all, there was one and only one course open for them—that of diverting their funds into the investment channel. Thus they were forced to embark on business hitherto considered to be outside their legitimate province, such as real estate loans, stock and bond collateral loans, investment in securities and so on. Having to cope with decreasing earnings in their ordinary fields of activity, they came to be guided entirely by the "yield" factor and to sacrifice "safety" and "liquidity" altogether.

An idea of what an enormous increase in the deposits of commercial banks occurred in the United States during 1922-27 may be formed from the following table regarding the Reporting Member Banks in leading cities.[1] This increase in deposits was accompanied by a parallel growth in investments and security loans, as will be evident from the figures already given for the same period.

Reporting Member Banks in Leading Cities

DEPOSITS

(In millions of Dollars)

	Year	Net Demand	Time
January	1922	10,362	3,017
December	1922	11,140	3,695
	1923	11,125	4,068
	1924	13,179	4,826
	1925	13,168	5,326
	1926	13,012	5,783
April	1927	13,041	6,088
December 31,	1929[3]	14,118	6,787
April 30,	1930[3]	13,581	7,055
September 24,	1930[3]	13,542	7,489

A most significant development in this enormous growth in bank deposits is the rapidly increasing importance of time

[1] Report of the Fed. Reserve Board for 1926, pp. 164-65.
[2] *Fed. Reserve Bulletin*, May, 1927, *op. cit.*
[3] *Fed. Reserve Bulletin*, Vol. XVI.

deposits. While both demand and time deposits have swelled, the latter have increased much more regularly and at a definitely higher rate than the former. In the table given above, time deposits increased during January, 1922—September, 1930, by more than 148%, while net demand deposits increased by only 30·7%. This huge relative increase in time deposits signifies a corresponding change in the status of the commercial banks. In the same manner the explanation of the increasing interest of French deposit banks in the industrial field during the period under review is to be found not only in the altered circumstances of the post-war period which we have already indicated but also in the enormous growth of deposits. The progressive diminution and afterwards complete cessation of the issue of short-term loans by the Treasury brought back to the banks as deposits a considerable portion of the capital that was formerly invested by their owners at 3 or 6 months in the National Defence Bonds. The following table clearly indicates the enormous increase of deposits in the case of the principal deposit banks of France[1]:—

Principal Deposit Banks

DEPOSITS FRS. (000,000 omitted)

1925	1929	1930
26,118	42,608	44,749
of which *Time Deposits*:		
718	2,890	3,219
Current Accounts:		
25,268	39,502	41,270

The tendency towards a relative increase of time as compared to demand deposits is unmistakable here as elsewhere.

1 Memorandum on Commercial Banks (1925-33), League of Nations, Geneva, 1934, p. 101.

The banks found that their deposits were largely increased while the opportunities for their profitable investment were not many. Hence they were obliged to explore suitable new avenues for their employment. The demand for increased capital by the older established businesses and for new capital by the growing number of newly established concerns was welcomed by the banks and the plethora of capital which was seeking employment was quickly diverted to these channels.

The absence of a suitable alternative employment for the increasing resources of commercial banks compelled them to branch out in the investment field not only in the case of France and America but also in that of Japan. After the spring of 1927, the deposits in the Japanese commercial banks swelled to enormous figures. At the end of 1928, all the clearing house banks, numbering 399, held deposits to the extent of 6,047,366,000 yen. This represented an increase of 585,853,000 yen over the previous year and an increase of 268,619,000 yen over the year before the crisis.[1]

The Japanese banks seemed to suffer from a plethora of credits for which they were almost unable to find a suitable channel of employment in the short loan market. Steps had been taken to reduce the rates of interest allowed on deposits and to receive new deposits to as small an extent as possible. But still they could not employ their funds in the wonted channels and were finding their business unremunerative. Some recent balance sheets available for the clearing house banks disclose that they were employing a large portion of their surplus resources in securities.[2] In the case of the Japanese "Big Five," deposits withdrawn after the crisis of 1927 found their way to them in large amounts. Their balance-sheets for 1928 show deposits totalling 3,129,969,000 yen which was an increase of 302,860,000

[1] *The Times Trade and Engineering Supplement*, Banking Number, June 29, 1929, p. 32.

[2] *The Times Trade and Engineering Supplement*, Banking Number, June 28, 1930, p. 25.

yen over 1927 and of 906,818,000 yen over 1926. The banks were compelled to enter the stock market in order to utilise their immense surplus funds.

Figures showing the deposit indices of the commercial banks in the United States, France and a number of other countries are available and they clearly indicate a general post-war trend for deposits to shift from sight or short-term to savings or long-term accounts. Thus it is found that in the case of the American national banks, the index for savings and time deposits rose from 100 in 1913 to 1,086 in 1929 while that for current accounts rose from 100 to 135 during the same period. In France the index for savings and time deposits and that for current accounts rose to 129 and 124 respectively. The tables given below strikingly illustrate this tendency[1]:—

	1913	20	21	22	23	24	25	26	27	28	29
U.S.A.:											
(a)	100	74	111	112	106	115	115	121	124	139	135
(b)	100	279	549	581	671	742	811	882	976	1,068	1,086
(c)	100	92	149	153	156	174	176	188	215	220	218
France:											
(a)	100	70	91	88	75	67	72	80	97	119	124
(b)	100	43	51	41	37	37	32	36	41	66	129
(c)	100	68	88	85	72	65	69	77	93	115	243

(a) Current.
(b) Savings and time.
(c) Total.

Tables exhibiting the same tendency may be given for other countries as well. Norway and a few other countries show a tendency towards the growth of demand deposits but they are

[1] Memorandum on Commercial Banks (1913-29), League of Nations, Table V, pp. 30-32.

not a real, only a formal, exception to this general trend towards a change in the composition of deposits.

This change in the composition of deposits was accompanied by a parallel movement in the composition of credits which showed a marked tendency to shift from shorter to longer accounts. A comparative study of the indices of "loans and advances" and "discounts" clearly demonstrates a remarkable tendency in post-war years for the former to increase relatively to the latter in all countries except England, France and Italy. But even in these countries, since 1921-23 "loans" tended to grow much faster than "discounts." Loans are not self-liquidating in the same sense as discounts and are advanced generally for longer periods. Thus credits tended to show a decisive shift in favour of long-term accounts. Again an examination of the indices for "investments" and "discounts, loans and advances" shows that the former increased relatively to the latter during recent years in the majority of countries, including Canada and the United States. Thus in the United States, the index for total discounts, loans and advances rose to 163 while that for securities and participations rose to 247. In Canada, the index for the former rose to 138 in 1929 while that for the latter rose to 286. The tables given below indicate illuminating trends for bank credits to shift from shorter to longer-term accounts in recent years[1]:—

	1913	20	21	22	23	24	25	26	27	28	29
U.S.A.:											
(c)	100	87	136	124	125	134	130	141	147	164	163
(d)	100	90	153	169	180	193	198	206	242	261	247
Canada.:											
(c)	100	82	100	94	92	85	89	104	117	131	138
(d)	100	165	233	213	266	319	321	303	334	435	286

[1] Memorandum on Commercial Banks (1913-29), League of Nations, Table V, p. 31.

France.:

(a)	100	70	100	98	78	65	71	79	88	106	118
(b)	100	45	49	42	40	45	38	42	49	78	94
(c)	100	60	80	76	62	57	58	64	72	93	109
(d)	100	30	42	41	31	29	24	25	26	25	30

(a) Discounts.
(b) Loans and advances.
(c) Total discounts, loans and advances.
(d) *Securities and participation.*

This change in the composition of bank credits is noticeable in the case of almost all countries. The exceptions are few and unimportant.

The parallelism between the movements of credits and deposits as brought out in the above tables, however rough it may be, is a very striking phenomenon and can hardly be purely accidental. "It would appear to reflect a change in the character of the operations of the commercial banks or a strengthening of tendencies previously at work in Europe at any rate." The banks devoted less attention than formerly to discount credits and were to an increasing extent financing industry by direct advances or working funds either on current accounts or in the form of long-term loans.[1]

The continued increase of deposits in the case of the German banks, it may be recalled, brought about a change in their character. They became more and more akin to deposit banks in pre-war England and America. The same factor, *viz.*, the growth of deposits, altered the status of the commercial banks elsewhere in quite a different, nay, quite an opposite direction.

Reconstruction of the Theory of Commercial Banking:

This widespread drift of commercial banks into investment channels has naturally excited a great deal of comment in the

[1] Memorandum on Commercial Banks (1925-33), League of Nations, Geneva, 1934, p. 7.

present times. It has served to focus our attention on the sound principles of commercial banking in a manner which would never have been thought of before. It seems as if the entire basis upon which commercial banking theory was built were being shaken to its foundation. Conditions have changed so entirely since the War, and the incidence of the recent world-wide depression on industry has been so severe, that opinion is rapidly gaining ground for a reconstruction of the whole theory of commercial banking.[1] The orthodox theory of commercial banking had been developed long before organised stock exchanges spread over the world. In those days the market for securities hardly existed and direct investments in them were practically immobilised: they were not convertible into cash at will or immediately. Under the circumstances the trade discount or the commercial bill was regarded as self-liquidating and definitely superior in point of liquidity to other types of bank loans. With the growth of recognised stock exchanges and the improvement and widening of the market for high-grade bonds, their unsaleable character has been removed and the whole question of "bank liquidity" has come to be viewed from an entirely new aspect. Marketable securities have begun to be considered, not unjustifiably, almost as liquid as, nay, even more liquid than, the customer's ordinary paper. For the banks can immediately furnish themselves with cash by their sale whereas the customer's paper can not be realised upon until the date of maturity. The meaning and nature of the concept of 'bank liquidity" has thus undergone a remarkable change and the practice of commercial banks to invest in marketable securities and to make loans secured by them has rapidly developed.[2]

[1] *Cf.* A. T. K. Grant, *A Study of the Capital Market in Post-War Britain*, p. 188, "The banks will be well-advised to take a wider view and in one way or another to lend for longer periods when they are satisfied that their clients are solvent. Certainly the danger of losing money through this type of lending might be less than the danger of depreciation on holdings of long-term Government securities purchased at prices so high that they were returning around 3 per cent."

[2] Memorandum on Commercial Banks (1925-33), League of Nations, Geneva, 1934, p. 7.

The point point has been made that in normal times and only excepting a serious financial crisis, high-grade bonds having a wide and active market may be liquidated without extraordinary losses. The commercial banks may therefore increase their reserve ratio more quickly through the sale of bonds than through the liquidation of the customer's paper. In times of emergency, however, the securities can be sold, if at all, at such heavy losses as to make liquidation impracticable. But it may be contended that, in a crisis, no paper is liquid.[1]

It may indeed be argued that the desire to keep commercial banking assets liquid because the deposits are at call or at short notice is a survival of a state of affairs which has ceased to exist. Individual banks are no longer exposed, in the same sense as of old, to their depositors coming and asking them for cash. The method by which the public, if so willing, proceeds to withdraw savings from the bank has changed. As Mr. Robertson has observed, "At present if depositors want to withdraw savings from their bank, it does not take the form of asking for notes but of spending their money more rapidly."[2] From the point of view of the banks as a whole nothing is withdrawn and there is practically no danger that anything will be withdrawn. "Though each individual deposit were payable on demand, the whole mass of deposits constitutes a mass of monetary obligations almost as fixed and immobile as the most stagnant type of banking asset." Industry is now obtaining its current finance from funds raised in the capital market and even more out of profits put to reserve. Banks are, therefore, deprived of an important type of their business. In the circumstances a case for a change in the policy of commercial banks with reference to industry is being put forward in many quarters. Thus Mr. A. T. K. Grant in a recent publication, referring to the present

1 "Social Aspects of Commercial Banking Theory"—an article by F. A. Bradford, in the *American Economic Review*, June, 1933, p. 219.

2 *Minutes of Evidence*, Committee on Finance and Industry, Vol. I, p. 8

tendency of British banks to remain holders of Government securities on a large scale, strongly urges them to reconsider their relations with industrial undertakings and the possibility of lending either directly or through associated financial enterprises for longer periods than they are prepared to do at present.[1] The danger of losing through this type of lending will not be greater than the risk of depreciation on holdings of long-term Government securities.

Merits of Mixed Banking :

This drift of commercial banks into the investment field is not without its advantages to industry. The history of German banking furnishes ample evidence as to how commercial banks carried on industrial financing without serious risks and certainly not without success. Judged by results, the combination of banking functions has not also been unsuccessful in Denmark and Switzerland. The deposit banks in Denmark have for a long time issued with success industrial shares and debentures and also made large loans against securities.[2] As Mr. Whale has pointed out, "The industrialist is in contact with the bank through his ordinary banking connection in the investment market. The bank knows his business intimately ; it can help him with the capital he requires for its development either by undertaking an issue of shares and debentures immediately or by making an advance in anticipation of such an issue at a later date ; it can advise even as to the outlook in the investment market ; and finally when an issue is made, its influence with the investing public goes far to ensure the successful placing of the securities." [3]

The mixed system of banking is not necessarily incompatible with sound banking. We do fully recognise that the primary duty of commercial banks is to look to the safety of the funds

[1] A. T. K. Grant, *A Study of the Capital Market in Post-War Britain.*

[2] A. M. Allen, etc., *Commercial Banking Legislation and Control*, p. 29.

[3] P. B. Whale, *Lectures on English and Continental Banking* (delivered March 26, 1931), *Journal of the Institute of Bankers*, July, 1931, p. 387.

entrusted to them by the depositors. For that they have to keep their assets as liquid as possible. We are not for a moment suggesting the adoption by them of any policy that would lock up their short-term funds, the demand deposits, in long-term loans to industry. But the paid-up capital of the banks, their surplus funds and the time and savings deposits represent resources which stand in a wholly different position from demand deposits; these are not subject to repayment on call. If capital and reserves are relatively large in proportion to deposits, and if a considerable portion of the deposits constitutes time and savings deposits, a portion of these funds may perhaps be legitimately employed in the long-term financing of industry. Real savings deposits represent investment surpluses of individuals and may, therefore, be properly used for fixed capital investment purposes. But an essential preliminary condition to the pursuit of this course with safety is the complete legal segregation of the savings bank department of a commercial bank, having its own books and balance sheets and separate special assets to meet the claims of its depositors. A much more legal and actual differentiation is also called for between time and demand deposits than exists at present. The possibility of confusing the two accounts must definitely be precluded. Time deposits may be made subject to 90 days' notice and the right to require notice should be obligatory and not merely optional. They should also be restricted to pass book type accounts and limited in size to a certain maximum. Only under such circumstances may the time and savings deposits be employed for long-term financing transactions, always taking care that such funds are held absolutely in the soundest assets.

The seriousness of risks may be greatly reduced by the pursuit of a cautious and judicious policy of carefully selected investments and by working in Syndicates. Among industrial securities, high-grade bonds having a wide and active market may be chosen, and the principle of diversification of interests may be followed carefully. The machinery of valuation

must be highly improved to guard against defective valuation, when advances are made on security of block of industrial concerns. Real estate loans should, however, be avoided as far as possible. They proved, it may be recalled, the weakest link in the recent American banking developments. There is a practice among certain banks of Europe to obtain funds for their less liquid investments by issuing 3 to 5 year debentures. For instance, the L'Union de Banques Suisses in Switzerland derives part of its working capital from the issue of its own bonds. The funds raised in this manner may also be legitimately employed for industrial financing.

Its Drawbacks :

At the same time it must be remembered that there are certain serious drawbacks of any such change in the policy of commercial banks. The investments of the resources of the banks in bonds and other securities is doubtless highly profitable in the years of prosperity and boom but in the years of depression when prices of securities depreciate, they find that a considerable portion of their assets have not only become "frozen" and unrealisable but that most of the value has disappeared. The deposit banks which had also become banques d'affaires found themselves in a hopelessly exposed position in the recent financial blizzard that swept from one end of the world to the other. The American banks, which had heavy commitments in the stock market either directly or through their investment affiliates, were seriously affected by the sharp fall in security prices. Dr. Goldschmidt has estimated that all told in the portfolios of commercial banks one-half to two billion dollars of securities became seriously endangered and even completely frozen in the recent crisis. Even at the minimum quotations of 1932, losses on these holdings amounted to more than one billion dollars representing about 10 % of the capital and reserves of all commercial banks.[1] The French and Japanese banks have also

[1] R. W. Goldschmidt *The Changing Structure of American Banking*, p. 105.

suffered tremendous losses owing to the pursuit of the same policy of heavy investments in industrial securities. In an earlier period (1920) the Swedish banks had to write off 700 million kronor mainly on account of industrial debts.[1]

There is another serious risk attending such practice. The policy of long-term investments is apt to be frequently carried beyond the limits of prudence. The banks will then be placed in a hopelessly unliquid position. In France, very recently the Banque Nationale de Credit broke down owing to a policy of imprudently immobilizing a considerable portion of its capital in industry and not sufficiently spreading out its risks.[2] At the same time it must be noticed that the other banques de depôts which had taken necessary steps to strengthen the liquidity of their position at the first signal of the approaching financial crisis were not so badly affected. The disastrous consequences of imprudent management are also illustrated by the difficulties of the Austrian Creditanstalt which are directly traceable to its being inextricably involved in the fortunes of Austrian industry. The recent activities of the American banks in the stock and the real estate market clearly demonstrate where this policy of mixing functions may ultimately lead the commercial banks. They fostered a spirit of speculation all over the economic structure which ultimately became " an epidemic and one so virulent that none of the usual antitoxins could stop its course until it had driven stock exchange quotations and real estate value to dizzy heights, placed several billions of very questionable home and foreign securities and

1 " Banking and Industry in Sweden "—an article by K. Weling Berger in *The Times Trade and Engineering Supplement*, Banking No., June 30, 1928, p. 19.

2 The Bank had made large advances to the Compioir Lyon Alemond. It got into difficulties in September, 1931, and a run on it began. The State had to interfere, creating a guarantee fund. Early in 1932 it was decided to wind up the institution and transfer its business to a new company. the Banque National pour le Commerce et l'Industrie whose capital was guaranteed by a Syndicate including the Bank of France, the Credit Lyonnais, etc.—The *Statist*, *Int. Banking Sec.*, Nov. 12, 1932. Also Memorandum on Commercial Banks 1925-83, (League of Nations), *Geneva*, 1934, p. 98.

lulled an increasing number of people into the illusion of paper riches and paper profits." [1] Banks in America rushed recklessly into the investment field. As a result many of them became hopelessly waterlogged with long-term bonds and real estate loans which were absolutely unrealisable and had to shut their doors. Even Federal Reserve Banks could not render any assistance to the distressed institutions as their real estate holdings and bond portfolios were not eligible as a basis of loan with the Reserve Banks. In connection with these bank failures some startling disclosures have been made as a result of Congressional investigation which show that various illegalities and excesses were committed by the more speculative banks and their numerous affiliates. Affiliates, for instance, were very frequently employed by the banks to give their own stock an activity and popularity which they did not possess. "Some entered into speculative commitments for the short or the long run, some financed stock operations of officers and directors of parent banks, others muddled in real estate operations and often manipulated the stock of the parent banks buying and selling and participating in pool operations." These activities are calculated to earn enormous profits so long as there is an upward tendency of the market but must end in losses as soon as the market falls. The panic of 1929 was "essentially a stock market convulsion" produced by the speculative activities of the banks and their subsidiaries.[2]

Recent Reaction—the Drive Against Mixed Banking :

The American Banking Act of 1933 took a serious view of the speculative activities indulged by the banks and their affiliates. The American public's fingers had been badly burnt and the whole development had come to be universally condemned. The Act

1 R. W. Goldschmidt, *The Changing Structure of American Banking*, 1933 p. 96.

2 "Speculative Activities of American Bankers"—an article by H. P. Willis in the *Banker*, February, 1931, p. 185.

appears to be vitally concerned with the dispersal of the menace of the banks' security affiliate; and a considerable portion of it has been occupied with this particular question.[1] Under its provisions commercial banks must divest themselves of their interest in any investment affiliate and must shun all issuing and underwriting activities. The Act endeavoured to bring about a complete divorcement between commercial and investment banking not only by tabooing the security affiliates of the commercial banks, but also by providing measures which are designed to keep investment banking strictly within its legitimate province and restrain it from infringing on commercial banking. Thus it was not only prescribed that after one year of the passage of the Act no member bank might be affiliated with any institution engaged principally in the issue, flotation, underwriting, public sale, or distribution of stocks, bonds, debentures, notes or other securities; but investment banks were also denied the right to receive deposits subject to cheque or to repayment on presentation of a pass book, certificate of deposit or other evidence of debt upon request of a depositor. Inter-locking directorates were declared unlawful and no officer of a member bank would be permitted to become a manager, director or other officer of an investment house.[2] The Banking Act of 1935 provided that the total amount of investment security of any one obligor held by a national bank should not exceed 10 per cent. of its capital and surplus.[3]

The segregation of commercial banking from investment banking proper has not been peculiar to the United States alone. Indeed one of the most remarkable trends of commercial banking in the years after the crisis has been the displacement of "mixed banking" not only in countries where the functions, originally

[1] Secs. 16, 18, 20, 32 and 33.

[2] "The Banking Act of 1933"—an article by R. B. Westerfield in the *Journal of Political Economy*, December, 1933.

[3] "The Banking Act of 1935"—an article by H. H. Preston in the *Journal of Political Economy*, December, 1935.

separate, became mixed up in the post-war years but also in countries which have been the traditional homes of such banking. In Germany, it will be recalled, recent legislation has definitely curbed the investment banking activities of the German banks. Under the German Credit Act of December 5, 1934, stocks other than permanent participations, and bonds not admitted to German stock exchanges that are owned by a credit institution shall not exceed a given percentage of its liabilities. Real estate holdings or permanent participations shall not also exceed the capital of such institution.[1] In Belgium from 1st January, 1936, all deposit banks, *i.e.*, "those, whose business it is to accept funds at interest payable within two years" have been prohibited from taking shares or participations in any commercial or industrial enterprise and those who were holding industrial securities were required to give them up before that date.[2] Swedish Banks which have played an important part in the provision of long- term industrial finance have been forbidden under the Bank Act of 1933 to acquire shares and lend on security except under certain specified conditions. In another country, Italy, where there was a banking tradition of long-term financing of industry, recent changes in banking strikingly illustrate the same tendency towards a complete separation of functions. The law of 1935 has prohibited the Argentine banks to hold for a period longer than two years after their purchase industrial shares or debentures to an amount exceeding 10% of their capital and 25% of their surplus and to participate in industrial, commercial or agricultural enterprises of any type.[3]

A survey of recent banking legislation in various countries discloses further an almost universal tendency to restrict ownership of real estate except bank premises. The case of Germany has already been mentioned. In Sweden banks may not acquire

[1] Sec. 17 (1) and (2)—*Fed. Reserve Bulletin*, January, 1935, p. 33.
[2] A. M. Allen, etc., *Commercial Banking Legislation and Control*, p. 86.
[3] *Ibid.*, pp. 27-28.

real estate except as a result of foreclosure but must dispose of it as soon as possible. In Denmark ownership of real estate other than bank premises has been restricted to 20% of the banks' capital. In Italy all proposed purchases of real estate have to be submitted to the Bank Inspectorate.[1] In America, no doubt, the terms on which national banks can make real estate loans have been somewhat liberalised by the Banking Act of 1935. They have been permitted to lend against real estate for a period of 10 years against a maximum of 5 years formerly and under certain conditions up to 60% of the estimated value of the property against 50% formerly. The aggregate amount of real estate loans to be made by national banks has also been increased from 50% of their time and savings deposits or 25% of their capital and surplus to 60% of their time and savings deposits or 100% of their capital and surplus whichever is greater.[2] But this is against the main tenor of recent banking legislation. The disastrous experience of American banks with such loans during the last boom does not certainly warrant such relaxation of law.

Speaking in 1931, it was argued by Mr. P. B. Whale that the advantages of the mixed system to industry might perhaps be best secured without exposing the depositor to any greater risk than he ran under the British system by the association of a deposit bank with an affiliated financing and issuing institution.[3] It is needless to say that the mixing up of the accounts of the two associated concerns should be scrupulously avoided. We have already noted the remarkable tendency on the part of American and French commercial banks to establish these subsidiary companies to carry on transactions hitherto considered to be outside the sphere of their activities. In Italy also the same kind of association of a commercial bank with an affiliated

1 Allen, Dark, etc., *Commercial Banking Legislation and Control*, op. cit.

2 "The Banking Act of 1935"—an article, by H. H. Preston in the *Journal of Political Economy*, December, 1935.

3 P. B. Whale" Lectures on English and Continental Banking" (delivered March 26, 1931), *Journal of the Institute of Bankers*, June, 1931, p. 390.

financing institution has been achieved in another manner. In America and France commercial banks established subsidiaries to carry on investment banking functions, while in Italy they are tending to shed their mixed banking character by forming affiliates to engage in industrial participations. When in 1930 the Credito Italiano was merged with the Banca Nazionale di Credito, it was decided that the former should specialise in banking business proper and the latter in long-term industrial financing.[1] By another agreement the industrial investments of the Banca Commerciale Italiana were taken over by a financial company, *viz.*, the Societa Finanziaria Industriale Italiana.[2] It may be recalled that the establishment of subsidiary companies has similarly tended to bring about a separation, and not a fusion, of banking functions in Germany. When the credit banks swerved round once again to deposit banking on the lines of the pre-war English system, special investment companies came to be established by them.[3] Prof. Henry Clay addressing the Manchester Statistical Society in 1932 also suggested that British banks might consider the possibility of forming security affiliates on American lines for the purpose of providing long-term capital to British industry. The suggestion was warmly endorsed by the *Economist*, though the paper stressed the importance of studying closely the implications and consequences of the American system of security affiliates.[4] But the inherent dangers in the operation of the security affiliates were clearly exposed during the inflationary period in America culminating in the stock-market crash of 1929, and we believe that their establishment is calculated to do more harm than good. Following the collapse, as already noted, further defects have been brought out in their plan of operation. The disastrous consequences of the speculative activities of the American banks'

[1] *The Statist, International Banking Section*, November 12, 1932, p. 704.

[2] *The Statist*, 7th and 14th November, 1931.

[3] P. B. Whale, *Joint-stock Banking in Germany*, pp. 272-73.

[4] *The Economist*, March 12 and April 30, 1932.

affiliates are still fresh in the public memory and must be taken into account when recommending their formation by the commercial banks of any country. The manner in which they entered into an orgy of speculation and involved the parent banks in enormous losses shattered all confidence in American banking. For all these reasons we hesitate to make any recommendation for adopting a similar policy of establishing security affiliates by commercial banks. We have no doubt that neither Prof. Clay nor Mr. Whale would ever have approved of the establishment of security affiliates if they were speaking in 1933 after the wild and nefarious activities of the American subsidiaries had been exposed to the full blaze of publicity as a result of Congressiona' investigation.

CHAPTER V

PROBLEMS OF INDUSTRIAL FINANCE IN INDIA : BANKS AND OTHER FACTORS IN INDIAN INDUSTRIAL FINANCING

The relationship between banks and industry having been examined, an analysis of the main problems of industrial finance in India may now be attempted. The principal agencies for the supply of industrial finance in the country are, (1) Joint-stock banks, (2) Managing Agents, (3) The State, (4) Local banks and Loan offices, (5) Indigenous bankers and money lenders. Deposits from the public also form an important source of finance in the cotton mill industry in some centres. Among all these factors, the Managing Agents play the most important part and constitute a unique feature of India's business organisation. With the passage of the State-Aid to Industries Acts in the various provinces in the country, the State is also taking an increasing interest in the financing of the industries of India. A detailed examination of the managing agency system in all its aspects will be made in the next chapter. A study of the part played by the State in the provision of industrial finance and an analysis of the working of the State-Aid to Industries Acts in the different provinces of the country will be made in a subsequent chapter. A review of the recent activities of the State elsewhere in the same direction will form an interesting and useful background for such a study and will also be attempted later on. The present chapter will be devoted to an examination of the main problems of industrial finance in India and the part played by the banks and other factors in providing it.

In the western countries the question of providing initial capital and that for extension and reorganisation of industry has assumed in recent years important proportions, and the problem of furnishing working capital to industry is only subordinate to that. The demand for short-term industrial credit has been met there fairly adequately and cheaply. The complaint on the part of industry is chiefly about long-dated capital. But the problem of industrial finance in India is not limited to the provision of long-term capital alone. The insufficiency of working capital and the high cost of such as is available are an important element in the problem of industrial finance here. While the attention of western countries to-day has been principally directed towards solving the problem of long-term industrial finance, India is concerned with the question of both short and long-term financial facilities for her industries.

Indian industry has to labour under specially great difficulties to raise its requisite long-term finances, whether for initial capital expenditure on land, machinery and buildings or for development, extension and reorganisation. The Indian investing public are proverbially shy and are reluctant to make direct investments in industry. Land constitutes perhaps the most attractive field for investments in India. Even those who seek other avenues of investments show a remarkable preference for government securities, municipal and port-trust loans and postal cash certificates, rather than for industrial shares and debentures.[1]

The banking system is modelled closely on the lines of the pre-war English deposit banking which has a long tradition of maintaining an attitude of aloofness from industry; and as such it is not at all equipped for the provision of long-term finance to industry. She has not the continental system of banking organisation nor does she possess the issue houses of England or the investment banks of the United States of America. Industries in India are unable to have their shares and deben-

1 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 433.

tures underwritten as is commonly done in the West. One or two wealthy financiers or firms of brokers may have occasionally underwritten the shares of some industrial companies. But there are no firms or groups of capitalists who make a regular business of underwriting industrial securities. There have even been instances in recent years where the promoters of certain public utility companies failed to get their issues underwritten on any terms.[1] Insurance companies are large institutional investors of industrial finance elsewhere. In Japan and the United States particularly they have played an important part in the provision of long-term finance by investing in mortgages on real estate and on factories as well as in industrial securities. The table given below showing the investments of insurance companies in Japan illustrates the various ways in which they have furnished this long-term finance[2] :—

Year.	No of Insurance Cos.	Mortgages on real estate. (In thousands of Yen)	Mortgages on factories.
1932-33 ...	89	82,070	118,836

Loans on securities.	Stocks.	Debentures.
220,418	332,179	482,828

The investments in the National and Local Bonds were only 212,727,000 yen. In the United States the funds of life insurance companies are frequently placed in mortgages and unlisted securities which are not particularly marketable but which afford a good yield.[3] In England also the distribution of insurance companies' investments (1934) shows that between a quarter and a third of their funds are in the form of securities in railway companies and industrial enterprises. The tendency towards an increased holding of industrial securities has manifested itself since 1920 and has been accentuated in recent years.[4]

1 Replies to a special questionnaire, Calcutta Stock Exchange Association, Ltd.—Indian Central Banking Enquiry Committee, Vol. II, p. 683.

2 Thirty-fourth Financial and Economic Annual of Japan, 1934, pp. 112-13.

3 C. P. Biddle and G. E. Bates, *Investment Banking*, pp. 11-12.

4 A. T. K. Grant, *A Study of the Capital Market in Post-War Britain* (1937), pp. 189-90.

In India, on the other hand, insurance companies have alway sput the bulk of their funds in government or semi-government securities and have generally avoided industrial securities and real estate mortgages. It is only in recent years that they have been taking an interest in the latter and the percentages of their investment in shares in Indian companies and mortgages on property have been increasing. But the majority of insurance companies in India have very little to do outside government, port-trust and municipal securities, and 70% of their asssts are still invested in them.[1] Under the provisions of Sec. 27 (1) of the recent Indian Insurance Act,[2] the insurance companies of our country will be compelled to invest 55 per cent. of their liabilities to holders of life insurance policies in government and government-approved securities. It will reverse whatever tendency they may have shown in recent times to function as providers of long-term capital for industry.

Methods of Raising Fixed Capital for Indian Industry :

The financing of fixed capital expenditure of industry is, as elsewhere, sought to be done out of paid-up share capital. The bulk of this paid-up capital is ordinary or common stock. Preference shares have been issued in some cases but they are not very popular in India. It appears that jute mills have relied more than the cotton mills on this source of financing. Out of the 59 jute mills given in the Investors' India Year Book (1938-39) as many as 52 issued preference shares. The amount of capital raised by means of preference shares formed nearly 34% of the total capital of the mills. Only 25 cotton mills out of 60 quoted issued preference shares amounting to 18·2% of the total paid-up capital. In the tea industry out of 130 companies only 25 issued preference shares amounting to Rs. 76,35,000

[1] In 1921, 1·5% of their assets was invested in shares of Indian companies and 1·67% in mortgages. The percentages in 1936 rose to 6·77 and 3·88 respectively. (Article in the *Calcutta Review* June 1939, p. 228.)

[2] The Indian Insurance Act, 1938, Sec. 27 (1).

while their ordinary shares were valued at Rs. 4,82,11,400 and the preference shares, therefore, formed only 14% of the total capital.[1] Of the 28 sugar companies whose shares are quoted in the Calcutta Stock Exchange only seven have issued preference shares (amounting to 8·2% of the total capital). In the iron and steel industry, the Tata Iron and Steel Co., Ltd., is a remarkable exception in that it has raised 70% of its share capital by means of preference shares.

As regards debenture finance, it is also interesting to note that unlike European countries, industries in India have not been able to resort to this form of finance to any very great extent. Debentures have always constituted an important source out of which industrial concerns in western countries have derived the necessary funds for meeting capital shortage in block or the expenditure for extensions and replacements or even normal working expenses. In India, in some cases, extensions and replacements of plant and machinery have no doubt been financed by the issue of debentures. But they are, as a rule, limited in vogue and constitute here a very small proportion of the total share capital of industrial enterprises. The following table brings out in striking fashion the insignificant part played by debentures in industrial financing in India[2] :—

	Joint-Stock Companies in Calcutta list.	Joint-Stock Companies in Bombay list.
Share Capital ...	Rs. 76·37 crores	Rs. 52·83 crores.
Debentures ...	„ 8·65 „	„ 17·51 „

Out of 59 jute mills quoted in the Investors' India Year Book 19 had debenture capital and the percentage of debenture to total capital was 10. Out of 60 cotton mills quoted only 16 issued debentures which represented 15·6% of the total share capital. In the tea industry debentures formed 4% only of the share capital. In the sugar industry the proportion of debenture to paid-up capital is higher than in any of the above industries. It is 22·9% of the total capital.

1 Investors' India Year Book, Place, Siddons & Gough, 1938-39.

2 Indian Central Banking Enquiry Committee, Vol. I, Part II (Minority Report), p. 335.

The relative insignificance of debenture capital in India is due to a variety of reasons. Mr. (now Sir) K. M. Macdonald, the Managing Governor of the Imperial Bank, made the point before the Indian Central Banking Enquiry Committee that debentures were not a popular method of investment with Indians, because most of the Indian investors had an attraction for speculation. The favourite consideration with them was capital appreciation rather than steady yield. Debentures, as a rule, offered little prospects for capital appreciation and therefore proved unattractive to them.[1] There may be a class of speculative investors whose only consideration is capital appreciation but that is not the entire explanation of the unpopularity of debentures. It does not explain the enormous amount invested by the Indian public in government securities, postal cash certificates and municipal and port-trust loans. The prospect of appreciation in value of such securities is not at all large, yet they attract a considerable number of investors. The unlikelihood of capital appreciation does not count much. It is the nature of the security offered which counts. When the security is satisfactory and the yield is sufficiently attractive, the public will subscribe readily. In Calcutta, jute mill debentures have proved an attractive field for investment. Jute mills have been here able to issue debentures at rates almost as cheap as those for government loans. The rate current for jute mill debentures in 1929 was 5½% which was only one-tenth per cent. higher than the rate payable by the Government of India for its loans and nearly ½% cheaper than the rate paid by the Bombay Municipality.[2] Sound jute mill debentures have often commanded a price which gives an even smaller return than is available in some government securities. The debenture issues of jute mill companies even under Indian managing agents, such as those of the Hukumchand Jute Mills and of the Birla Jute Manufac-

1 Statement of Evidence of Mr. K. M. Macdonald, Indian Central Banking Enquiry Committee, Vol. II, p. 226.

2 *The Capital*, 19th September, 1929.

turing Co., have been sold without much difficulty. Debentures of tea companies are also sought after in Calcutta.[1] Debentures of cotton mills have not, however, been so popular a method of investment in Bombay. This is entirely due to the low state into which the industry fell in recent years. Until the prospects of Bombay mills waned, debentures were even more current than in Calcutta.[2]

The payment of initial stamp duty has often been considered to be a cause of the unpopularity of debentures. In addition to the usual interest, the industrial company issuing debentures has to pay the initial legal and stamp charges (¾% plus charges for registration) and also an underwriting commission varying from 2 to 5%. But the question of initial stamp duty has hardly any bearing on the popularity or otherwise of industrial debentures. No stamp duty has to be paid on debentures by the purchaser unless they are in registered form, of which there are not more than about half a dozen in Calcutta. The stamp duty in that case is the same as for share transfers.[3]

The true reasons for the unpopularity of debentures must be sought elsewhere. In the first place, there are no issue houses in India to help the debenture issues. There are no institutional investors which could take up the debenture issues of various industrial companies. The Imperial Bank of India Act of 1920 did not permit the Bank to hold them, although that restriction has recently been removed on the establishment of the Reserve Bank and the consequent passing of the Imperial Bank of India (Amendment) Act, 1934.[4] The other joint-stock banks do not take to them as there is not always a ready market for their

[1] Evidence of Exchange Bankers' Association, Indian Central Banking Enquiry Committee, Vol. III, p. 828.

[2] Statement of Evidence of Mr. F. E. Dinshaw, Indian Central Banking Enquiry Committee, Vol. II, p. 456.

[3] Calcutta Stock Exchange Association: Replies to a special questionnaire.—Indian Central Banking Enquiry Committee, Vol. II, p. 682.

[4] Sec. 15 (1) of the Imperial Bank of India (Amendment) Act, 1934.

disposal. The size of most of the debentures is small and they are taken up almost entirely by a limited group of financiers. The majority of the debentures issued by cotton mills in Bombay were taken up by Indian princes and wealthy merchants. An issue of debentures worth Rs. 25 lakhs by the Simplex Mills was entirely held by the Chartered Bank.[1] Under the circumstances no real market is created for the issues. The debentures of the Tata Iron and Steel Company and of the Tata Hydro-Electric Company are two of the few exceptions where they have a regular market.

The attitude of the banks has perhaps been most responsible for the unpopularity of debentures as a method of industrial financing in the country. The proceedings of the Indian Central Banking Enquiry Committee proved beyond the shadow of doubt that industrial concerns which had issued debentures were not looked upon with favour by the banks. Their credit with the banks became impaired and they found it difficult to secure bank loans and cash credits on the usual terms. It must be a very narrow view, as Dr. Jeidels observed, that simply because a concern was not exclusively financed by its share capital, it was not eligible for banking accommodation.[2]

In the western countries there are noticeable, in recent years, two unmistakable trends in industrial financing. During the period 1925-31 preference shares gained increasing popularity among investors in the West. There was an almost universal tendency among the public to invest their savings in preferred rather than in ordinary shares which have to carry the full risks of the industry. The composition of the share capital of business corporations accordingly underwent a remarkable change. In the United States, preference stocks formed in 1929 24·1% of common stocks while they had formed only 22·7%

[1] Evidence of Mr. A. D. Shroff, Indian Central Banking Enquiry Committee, Vol. III, p. 206.

[2] *Discussions with Foreign Experts*, Indian Central Banking Enquiry Committee, Vol. IV, p. 163.

in 1924. Similarly in the United Kingdom, the percentage of preferred to ordinary capital rose from 56·5% in 1924 to 58·4% in 1929.[1] This relative increase in preference shares was partly the outcome of the prevailing economic conditions of a disturbed period which increased the general insecurity of business enterprises. Investors were generally unwilling to face the full risks which the holding of ordinary shares must imply and were guided by considerations of "safety" rather than of "yield." But "the tendency is also partly the result of an increase in the number of small share-holders and in the amounts of capital accumulated by financial institutions such as insurance companies owing to widely dispersed small savings."

There was also a general tendency among capital importing countries in the West for debentures of business corporations to increase in relation to owned capital. In Germany, for instance, the proportion of debt obligations to capital increased between 1925 and 1929 from 57·1% to 84·2% and in Hungary between 1927 and 1929 from 78·1% to 99·2%. Even in the case of the capital exporting countries the absolute, though not the relative, amount of indebtedness increased substantially as in the case of the United States or was well maintained at practically the same level as in that of the United Kingdom.[2] When the boom came to an end in 1929, industry in general had to carry a much heavier load of debt than in the preceding years of prosperity. The earnings rapidly shrank in the depression years but the fixed charges upon this debt remained as a heavy burden upon industry and took a big slice out of the diminishing profits. The capital invested in equities may be deprived of its dividends but the debt charges have to be paid at all costs to avoid the risks of default.

It would be interesting to contrast these recent trends in the industrial financing of western countries with the position in

1 *The World Economic Survey* (League of Nations), 1932-33, p. 140.

2 *Ibid.*, pp. 138-39.

India. It is unfortunate that figures for ordinary and preference capital and for debentures of Indian joint-stock companies are not available separately. The percentage of preferred to ordinary stocks and that of debentures to paid-up capital in the case of business corporations as a whole cannot, therefore, be arrived at.[1] But from a study of the position in the case of some representative industries such as cotton, jute, tea and sugar, there appears to be no evidence that the proportion has increased either in the case of preference shares or in that of debentures. In the case of the tea industry, for instance, for which detailed figures are available, the position in regard to debentures and preference shares is as follows :—

For the year	Pref. Shares.	Ord. Shares.	Debentures.
1925	25,20,000	2,58,36,000	8,29,000
1926	25,20,000	2,59,48,150	6,30,000
1927	25,20,000	2,60,58,150	6,00,000
1928	25,20,000	2,61,08,150	5,65,500
1929	25,20,000	2,57,48,150	4,63,500
1930	25,20,000	2,56,48,150	4,63,500

The amount of preference shares has remained constant while debentures have declined relatively to total capital. A well-known firm of stock and share brokers in Calcutta has also informed the writer that the trends observed in the case of western countries during 1925-31 have not been noticeable in India.[2] There has been here no tendency to construct companies with a relatively large proportion of debentures, although there have been notable exceptions in connection with one or two

[1] The writer approached the Director-General of Commercial Intelligence and Statistics, Government of India, for the necessary figures but in a letter, dated the 9th September, 1935, he regretted that the figures were not available.

[2] Source : Messrs. Place, Siddons and Gough, Stock and Share Brokers, Calcutta in their letter to the writer, dated the 6th February, 1936.

sugar companies which have been constructed with an unduly heavy proportion of debenture capital.

In India, the absence of any tendency for debentures to grow in relation to owned capital has relieved industrial enterprises of the same depressing influence upon their profits that was noticeable in western countries during the depression period. In the case of the few sugar companies which were constructed with an unduly heavy proportion of debentures, it has been observed, especially since the imposition of the new excise duty, that estimated profits have not materialised and they now find themselves loaded with debentures for which it is difficult to provide the interest.[1]

Problems of Long-Term Industrial Finance :

The difficulties of obtaining initial capital for industry, though no doubt very great in the present circumstances of India, have been perhaps over-stressed. Industries floated on sound lines and showing reasonable prospects of success have not been unable to secure the financial support of the investing public. This view is endorsed by the evidences of the Bengal Chamber of Commerce,[2] the Exchange Banks Association[3] and the Imperial Bank of India[4] before the Indian Central Banking Enquiry Committee. It is further supported by the recent representations of the Bombay Shareholders' Association before the Government of India regarding amendment of the Indian Companies Act.[5] The larger industrial undertakings, specially those under the management of well-known firms of managing agents, have hardly experienced any difficulty in raising the necessary amount of their share capital. The imprimatur of managing agents has not always been necessary. The

[1] Letter to the writer from Messrs Place, Siddons and Gough, *op. cit.*
[2] Indian Central Banking Enquiry Committee, Vol. II. p. 472.
[3] *Ibid.*, Vol. II, p. 625.
[4] *Ibid*, Vol. I, Part I, p. 268.
[5] *Indian Companies Act : Case for Amendment*, p. 2.

Dhakeswari Cotton Mill which is not under the system of managing agents experienced no difficulty in raising the whole of its share capital.[1] In the case of the protected industries like sugar and matches there has also been no lack of interest on the part of the investing public and in several instances the share capital has been wholly taken up within a short period of its issue. Industries which have offered high rates of dividends have not failed to attract investors and in the tea industry, we have the testimony of a well-known tea magnate, shares were often oversubscribed.[2] During the boom periods, it is well-known, the activities of the Indian public in the stock market were even as great as those of any other public in the stock markets of any other country. In the hectic years of the post-war boom enormous funds were freely invested in industry as will be evident from the figures given below, showing the net capital invested in joint-stock companies during 1920-21 and 1921-22[3] :—

Rs.
1920-21—41·2 crores.
1921-22—66·1 crores.

A good proposition has seldom lacked the support of the investing public. Whenever the investors regard in their own way that a concern is likely to be successful and promising, funds have flown freely. The jute, cotton, tea and coal companies which could give some assurance of success have always attracted the investors. Even in the case of a pioneering enterprise as the steel industry, the public have not failed to respond. It is indeed surprising that the Indian public have still been coming forward with their purse, although they have been subjected to severe losses owing to the numerous liquidations of joint-stock

1 Indian Tariff Board, 1931 : Evidence of Mr. A. B. Guha, Managing Director. The cement companies also were able to raise their capital without the help of managing agents.

2 Evidence of Mr. (now Dr.) Rahman, Bengal Provincial Banking Enquiry Committee.

3 Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 300.

companies in the post-war slump and the enormons bank failures of 1913-17.

There is no doubt that business outside the usual lines, untried and untested, has no attraction for the investing public, but this is true not only of India but also of every other country. The problem of raising initial capital is more acute in the case of smaller concerns in the larger industries and in the medium-sized and smaller businesses generally. Such enterprises have, it has already been noted, felt severe handicaps in raising their initial capital elsewhere where the capital market is highly organised. They must experience uncommon difficulties in India where the capital market is not organised at all and issue houses and underwriting firms are conspicuous by their absence. Rice mills, soap factories, collieries, oil mills, hosieries and a host of similar medium-sized and smaller enterprises are unable to obtain the necessary initial finances for meeting the fixed capital expenditure on purchase of land, installation of machinery and erection of factory buildings. If they are run on individual proprietary basis, the limits of the personal investments of the owners are quickly reached. Even when they are owned and managed by joint-stock companies, they do not fare better in the matter of securing the initial capital. Generally speaking, the realisations from their share flotations fail to meet their requirements for fixed capital expenditure. [1]

Problems of long-term industrial finance, however, are not confined to the raising of inital capital by means of share flotations. A more important group of problems is connected with the question of obtaining fairly long-term financial facilities during the development period of a business. The amount that is realised by the selling of shares is soon exhausted in acquiring the land, setting up the factory, installing the machinery and providing other equipments. The concern is faced with the acute problem of finding the requisite funds to develop and carry

[1] Statement of Evidence of the Bengal National Chamber of Commerce, Indian Central Banking Enquiry Committee, Vol. II, p. 484.

on the business, till it becomes a paying proposition. In some industries several years might elapse before the concern is able to come to this stage. A reference to tea gardens finance in Bengal and Assam brings into clear relief the difficulties experienced by Indian industries generally to obtain the necessary long-term finances during the development period. By its very nature the tea industry requires considerable initial capital expenditure. A garden to be worked economically should have an average size of at least 500 acres. The acquisition of land costs nearly a lakh of rupees. The expenditure on account of machinery runs to another lakh. There is further expenditure to be met for construction of roads and bridges and for building bungalows for managers and quarters for labourers. Besides all this expenditure, a considerable amount has to be incurred for opening out and carrying on an estate before it becomes a paying proposition. The garden begins to yield crops from the fourth year and becomes a paying proposition in at least the sixth or seventh year. The cost of opening out a garden has been estimated to be between Rs. 1,500 and Rs. 3,000 per planted acre.[1] Besides the three and half lakhs required for meeting the initial fixed capital expenditure an almost equal amount has to be incurred without any return during the development period. It has been found by experience that an Indian tea company is generally able to raise about 3 lakhs of rupees by floating shares and hence the subscribed capital does not provide more than 50% of the entire amount required.[2] The funds obtained from this source are exhausted in the course of two or three years in purchasing land and machinery and erecting buildings. Soon the gardens have to seek finance from outside sources to meet the expenses of the development period. A legal and equitable mortgage of the property, garden and machinery has to be

1 Evidence of Mr. E. S. Roffey.—Proceedings of the Assam Provincial Banking Enquiry Committee, Vol. II, p. 262.

2 Evidence of Representatives of Indian Tea Planters' Association, Indian Central Banking Enquiry Committee, Vol. III, pp. 675-76.

executed and the loans are raised on this mortgage from loan offices, Marwari merchants and other money-lenders for a period of 7 to 10 years.[1] The rate of interest varies from 12 to 21% in the case of advances from indigenous bankers and money-lenders and is a little lower (varying from 9 to 12%) in the case of those from loan offices or local banks.[2] In Assam the interest charged by the local Kyah firms for such advances is 12%.[3] No joint-stock bank will ordinarily lend against the mortgage of such property. There is also no other organisation which can make advances for a fairly long-term on the security of the fixed assets of industry. Under the circumstances the rates of interest are unduly high and the guarantee of the managing agents or directors is to be given in addition. A worse feature is that loans even on such terms are not available readily to the borrowers. The newly established concerns become sorely handicapped and are compelled in many cases to cut down their development programmes. Mr. E. S. Roffey, who had extensive experience of tea gardens finance, rightly observed that the most difficult and worrying business with the opening out of a tea estate was the question of obtaining the necessary finance thereof.

The same difficulties of obtaining the necessary finances during the development period are found in a greater degree in the case of the medium and smaller sized businesses where, as already noted, the realisations from share capital are too slender to meet even the initial fixed capital expenditure. Their dependence on outside sources is even more pronounced. The necessary loans are obtained as usual from indigenous bankers at exorbitant rates of interest against the mortgage of real

1 Evidence of Representatives of Indian Tea Planters' Association, Indian Central Banking Enquiry Committee, Vol. III, pp. 675-76. Also Letter from the Secretary, Indian Tea Planters' Association, Indian Central Banking Enquiry Committee, Vol. II, p. 658.

2 Bengal Provincial Banking Enquiry Committee, p. 120.

3 Assam Provincial Banking Enquiry Committee, Vol. II, p. 262.

property plus the personal guarantee of directors or managing agents. Rates vary from 12 to 18% while 24 to 30% have also been known. All this money for development though avowedly for the purpose of block investment is obtainable only on hundies.[1]

Not only is there this problem of finding the necessary finances for newly established concerns during the period of development but there is the question of obtaining for the established concerns the capital required for extension, modernisation and replacement of machinery. How seriously the lack of such capital is acting as a drag on Indian industry can be well illustrated by a reference to the position in the cotton mill industry of Bombay. Cotton mills require in many instances long-dated capital to enlarge the scale of operation and for installations of new plant and machinery, such as for combing and finishing, for mercerising, for loom widening and so on. To increase production and reduce cost, the replacement of old plant and the introduction of new methods and systems of manufacture are urgently called for. Without these innovations and additions the import trade in important varieties of goods cannot be captured. But the resources of the mills are hopelessly inadequate to finance the development of industry along these lines.[2]

Perhaps the most important problem of long-term industrial finance relates to the question of finding the requisite funds for carrying on the rationalisation of Indian industry. During the last few years the movement for rationalisation has gathered considerable force in the industrial countries of the world. Important and far-reaching schemes have been adopted in various countries, Germany, Italy, Japan, Great Britain and the United

1 Statement of Evidence by the Bengal National Chamber of Commerce, Indian Central Banking Enquiry Committee, Vol. II, p. 504.

2 Representation of the Bombay Millowners' Association to the Tariff Board (Cotton Textile Industry), 1932.

States, to reorganise some of the larger industries such as iron and steel, cotton, coal, wool, etc. The wide variety of international competition and the incidence of the recent unprecedented depression have made it urgent for almost every branch of industry to adopt some kind of reorganisation. Rationalisation for some of the major and important industries in India is also urgently called for. In the jute, cotton, cement, sugar, steel and coal industries, the problem has become specially important. The financing of any scheme of reorganisation and amalgamation will require enormous funds. The failure of the recent ambitious scheme of rationalisation in the Bombay mill industry well illustrates the difficulties of raising the necessary funds for financing such schemes. In 1931 a merger of over 30 mills was contemplated. A merger committee was formed and the Finance Member of the Government of India and the Imperial Bank of India were approached. Informal negotiations took place to find out the amount of assistance that would be forthcoming in carrying out the idea. But unfortunately the merger plan had to be abandoned because the difficulties of obtaining the considerable amount of the necessary finance were found to be specially great.[1] It is only to be hoped that the considerable amounts of money necessary to finance merger schemes in other industries will be found and that they will not meet with the same fate as that of the Bombay mill industry.

Indian Banks and the Financing of Industries :

The main problems of long-term industrial finance in India having been analysed, an examination may now be made of the part played by the banking system of the country in the financing of its industries. There has been for a long time an undercurrent of feeling that the Indian banks are reluctant to furnish finance for fixed capital expenditure of industry. Not only

1. Representation of the Bombay Millowners' Association, Indian Tariff Board (Cotton Textile Industry), 1932, p. 23.

before the Indian Industrial Commission of 1916, but also before the Central and Provincial Banking Enquiry Committees, a considerable number of witnesses made the point that the relations of Indian banks to Indian industry were far from satisfactory in this respect. This criticism of the attitude of the Indian banks towards industry has been fostered to a great extent by the prevailing misconceptions as to the true nature and functions of the German banks.

The Indian banking system consists of the Reserve Bank, the Imperial Bank, the Joint-Stock Banks and the Exchange Banks. The Reserve Bank of India is a true Central Bank and as such will operate under the usual network of restrictions to which central banking institutions are subject. It can have no interest in or close relationship with industry. The Imperial Bank of India, the biggest joint-stock bank in the country, was debarred by the Act of 1920 from granting loans for a longer period than six months. With the establishment of the Reserve Bank of India and the consequent removal of its character as a Central Bank, it has been freed from some of the restrictions that had previously existed on its business but even now it cannot make any loan or advance for a longer period except in certain special cases when the maximum is nine months only.[1] It cannot also lend upon mortgage or in any other manner upon the security of any immovable property except in the case of estates under the charge of courts of wards.[2] The other Indian joint-stock banks are essentially commercial banks and are not equipped for the task of providing long-term industrial finance. The share of the Exchange banks in industrial financing is practically nil. They are founded and controlled by foreigners and they cannot possibly have any interest in the indigenous industries. Whatever part is played by the banking system of India in the sphere of industrial financing

1 The Imperial Bank of India (Amendment) Act, 1934, S. 12 (2).

2 See Schedule I, Part II. Business which the Bank is not authorised to transact.

relates to the provision of current finance and not to that of long-dated capital.

Trends towards Long-Term Industrial Financing :

Although banking policy in India has generally been confined to the provision of working capital to industry, yet there were at least two distinct periods in the banking history of the country when Indian joint-stock banks showed a remarkable tendency towards the long-term financing of industry. Attempts at such industrial financing were made for the first time by a number of commercial banks, mostly in the Punjab, during the Swadeshi movement of 1906-13. The whole country was swayed by the new spirit of Swadeshi and there was a widespread desire to foster the indigenous industries. A rapid development of joint-stock banking took place about that time. The new joint-stock banks undertook various types of business and developed an unmistakable tendency to provide long-term finance to industry.[1] They deliberately employed their funds in channels closed to orthodox commercial banking and undertook all the various methods of investment banking. They subscribed to the shares and debentures of industrial companies and freely advanced considerable sums on the security of factories, machinery, plant, buildings, and so on. The more prominent among these Swadeshi banks which went in for long-term financing of industries were the People's Bank of the Punjab, the Indian Specie Bank, the Hindusthan Bank, the Lahore Bank, the Doaba Bank, the Marwar Bank, the Industrial Bank and the Credit Bank of India.[2]

The People's Bank which had a paid-up capital of Rs. 13 lakhs was started as an ordinary commercial bank but embarked subsequently upon industrial financing. The Bank made large advances to various industrial concerns on the security of machinery

[1] Vera Anstey, *Economic Development of India*, p. 407.

[2] Proceedings of the Sixth Annual Conference, Indian Economic Association, 1923.

and buildings. More than 90 lakhs of its money were sunk in them. The "locking up" of such a considerable portion of its resources brought about the inevitable crash and the Bank closed its doors. An idea may be formed of the financial commitments of the Bank in industry from the enormous amounts advanced to the following industrial concerns [1]:—

	Rs.
1. The Punjab Spinning and Weaving Mills Co., Ltd.	20,00,000
2. The Lahore Spinning and Weaving Mills Co., Ltd.	7,50,000
3. The Pioneer Investment Co., Ltd., Lahore ...	8,50,000
4. The Surat People's Spinning & Weaving Mills ...	4,50,000
5. Debentures in the Lahore Spinning and Weaving Mills	1,00,000

Besides it granted along with the Amritsar Bank a loan amounting to 15 lakhs of rupees to the Upper India Real Estate Company which speculated in land.[2]

The Hindusthan Bank heavily financed the Punjab Musical Association, a theatre having no capital and the Punjab Bros. Company, a speculative shop at Karachi. The Industrial Bank lent considerable sums to its chief promoter and his concerns. The Bank made large advances to ginning factories and on the shares of allied companies. The Lahore Bank advanced large sums to one of its directors and its chief manager. It had a large investment in a leather factory in which its promoters were interested. Similarly the Doaba Bank made advances to the Amritsar General and Flour Mills and to the Phagwara Mills in Kapurthala State in both of which its directors had an interest.[3]

A large number of other banks failed and there was a severe banking crisis in 1913-15. No less than 34% of the total paid-up capital of Indian joint-stock banks was lost during 1913-17. The failure of many of these banks in this period is to be-

[1] Indian Industrial Commission, 1916, *Minutes of Evidence*, Vol. V, App. VIII, p. 826. (Memorandum of Mr. Findlay Shirras)

[2] Evidence of Rai Bahadur L. D. Das, Additional Judge in charge of Liquidation work, Lahore.—Indian Industrial Commission, *Minutes of Evidence*, Vol. V, p. 267.

[3] Industrial Commission 1916, *Minutes of Evidence*, Vol. V, p. 254.

attributed to the fact that they advanced money recklessly to industrial ventures which did not pay.[1] "Frenzied speculation and imprudent and reckless loans" characterised the activities of these 'Swadeshi' banks. Every known principle of investment banking was violated. They were primarily deposit banks and the policy of locking up almost the whole of their resources in long-term industrial investments, unrealisable at the time of a crisis, was inevitably followed by disastrous consequences. Their paid-up capital was low in proportion to their liabilities, and the short-term deposits in many instances were employed for long-term financing of industry. The principle of carefully distributing the risks of investment was never followed. Again, the banks used to pay very high rates of interest, even 6% on the deposits. Hence they were obliged to invest in speculative enterprises to earn sufficiently large profits to meet expenses and pay the high interest. Besides, the affairs of the banks were grossly mismanaged. In almost every case the banks were made to finance the pet concerns of their promoters or to lend money to the directors and managers or to companies in which they were partners. One bank advanced no less than Rs. 71,72,637-13-1 out of a total advance of Rs. 1,07,00,000-14-1 to companies or other concerns in which some of its directors were interested as individuals, directors or as joint-borrowers. In many cases the management had been so utterly inefficient that doubts were entertained as to the *bona-fides* of the directors. There was a widespread feeling that the directors had advanced money knowing fully well that recovery was doubtful. Dividends sometimes were paid out of capital and in some cases the companies' assets were deliberately done away with. A debt of 4 lakhs of rupees was found by audit to be due to the People's Bank from the Ganges Flour Mills whereas the balance-sheet of the company showed no debt due to the Bank. In the case of the People's

[1] Vera Anstey, *Economic Development of India*, p. 407. Also Findlay Shirras, *Indian Banking and Finance*, p. 385.

Bank and the Amritsar Bank the auditors pointed out that in many accounts interest was not being recovered and the same was being debited to different accounts and credited to profit and loss account. The financial position of the debtor companies was extremely unsound and the securities held by the banks were not sufficient to cover the debts. It is interesting to quote the remarks made by the auditors in regard to the investments of the People's Bank in the Pioneer Investment Co.: "The securities held by the bank are short by Rs. 30,687-2-6, if the value of the shares of all the companies held as securities be accepted at par. But as a matter of fact, the value of the shares held as security has not only considerably fallen but (in our opinion) the majority of shares are not worth the paper on which they are written."[1]

It has sometimes been contended that the crisis in the Punjab banks was engineered by Europeans who wanted to put down banking in India. Their failure, it has been urged, was not due to pursuit of any imprudent policy and the security was ample, the depositors in many cases being paid 16 as. in the rupee. But the startling disclosures made in the Liquidators' Reports throw a flood of light on the activities of these banks. They not only pursued a policy of reckless speculation but were also frequently guilty of hopeless mismanagement and even of dishonest practices. From the preceding discussion, it is abundantly clear that the banking crisis was not engineered by the designs of any interested party. It was entirely due to their own imprudent policy. As for the contention that depositors got 16 as. in the rupee after liquidation, it must be mentioned that they were mostly paid after recovery from the unfortunate shareholders and seldom from the assets of the banks themselves. The assets in the majority of cases were absolutely worthless.

It was in the post-war years that the same trend towards long-term financing of industry could be noticed once more among

[1] A note prepared from the letter, dated 12th August, 1913, from Messrs. Basantram & Sons, auditors of the People's Bank, to the directors of the bank published in the *Arya Patrika* of 25th October, 1913. See Indian Central Banking Enquiry Committee, Vol. II, p. 816.

Indian joint-stock banks. During the war-end boom, there was an outburst of company floating activity and the opportunity was seized upon, as in the Swadeshi period, to establish " banks " for financing indigenous industries. The avowed object of these banks, we are quoting from the prospectus of one of the many that were formed, was " to finance and assist the development of existing and new indigenous industrial and agricultural concerns."[1] The spectacular industrial progress of Japan in the closing years and that of Germany in the earlier years of the nineteenth century had captured the imagination of our countrymen and it was believed that the banks there had filled an important rôle in this rapid industrialisation. The advantages to be derived from industrial banks and the part played by them in the industrial progress of Japan and Germany were also stressed in the prospectuses of many of the so-called industrial banks started at that time. Lack of finance, it was urged, was hampering the development of Indian industries in the same way.[2] Thus the idea of forming " industrial banks " originated and having once originated, spread very rapidly and soon developed into a craze for such banking. Like mushrooms they began to crop up everywhere. " They became the fashion of the day, the vogue of the times and for some time one heard nothing but of industrial banks, which made their *début* in the North and South, the East and West."[3]

Among the banks which were started at the time with the title of " industrial banks," the following may be mentioned :—

	Industrial Bank.	Paid-up Capital. Rs.	A.	P.	Year of Registration.
1.	The Tata Industrial Bank	2,25,19,957	8	0	1917
2.	The Calcutta Industrial Bank	79,53,570	0	0	1919
3.	The Indian Industrial Bank	3,48,367	5	0	1919

[1] Prospectus of the Calcutta Industrial Bank, filed 25th September, 1919.

[2] Prospectus of the Indian Industrial Bank, registered 26th November, 1919.

[3] Statement of Evidence submitted by the Editors, *Indian Finance*.—Indian Central Banking Enquiry Committee, Vol. II, p. 192.

	Industrial Bank.	Paid-up Capital. Rs.	A.	P.	Year of Registration.
4.	The Karnani Industrial Bank	60,00,000	0	0	1921
5.	The Raikat Industrial Bank	2,47,000	0	0	1922
6.	The Luxmi Industrial Bank	1,01,000	0	0	1923
7.	The Mysore Industrial Bank	6,07,000	0	0	1920
8.	The Industrial Bank of Western India	39,97,000	0	0	1919

The Tata Industrial Bank:

Among all these so-called industrial banks, the Tata Industrial Bank, the earliest and the largest of them, attracted considerable notice. Even the attention of the Industrial Commission was drawn towards it and they belauded in their Report the possibilities of industrial banking in the country on similar lines.

The Tata Bank was established with an authorised capital of Rs. 12 crores, of which more than two crores were fully paid up by September, 1922. At the outset the Bank showed signs of a career full of brilliant promise. Its shares rapidly rose in the Stock Exchange and within three months from the date of issue they were at a premium of Rs. 60. They were subsequently at a premium of even Rs. 100. Besides the head office and two branches in Bombay, the Bank opened branches in twelve other centres: Calcutta, Rangoon, Madras, Hyderabad, Cawnpore, Lucknow, Delhi, Asansol, Aminabad, Hapur, Dhanbad and Chandausi.

As an industrial bank, its special business, as outlined by its Chairman in a meeting of the bank, was to finance the development of new and existing industries, not only to promote industrial companies and support them by underwriting their shares and debentures but also to be always prepared to retain a considerable holding of shares in such companies, as an earnest of its belief in the *bona-fides* and prospects of the companies concerned.[1] The Bank did not want to manage an industrial

[1] Speech of the Chairman at a meeting of the Tata Industrial Bank, May, 1923.

concern actually but simply to finance certain subsidiary companies. The Industrial Finance, Ltd., was formed for the purpose. The holdings of the Bank in this company amounted to 16,200 fully paid shares of Rs. 100 each at the end of September, 1922.[1]

The Bank, however, did not confine itself to industrial business solely. A glance at the balance-sheets that were published every six months reveals that it undertook every description of banking business, including that of exchange, acceptance of demand and fixed deposits, discounting of bills, granting of cash credits and demand loans, etc.

The high hopes entertained about the Bank unfortunately failed to materialise. Although the profits of the ordinary banking side of its business were well maintained and compared favourably with those realised by other banks operating in the country, the results achieved by the Bank's industrial activities were disappointing. With every year its industrial holdings continued to suffer increasing depreciation. Within a short time 26 lakhs of its capital were locked up and later on at one time 40 lakhs of its capital became entangled and a loss of 11 lakhs had to be written off its investment in new industrial companies.[2] In 1922 the authorities of the Bank decided to suspend the Industrial Department and to retire capital from industry and utilise it for ordinary banking. In the course of an explanatory memorandum issued by the Bank to its shareholders, dated 7th May, 1923, it was stated that the directors had decided to abandon industrial financing. The liquid position of the Bank was emphasised, the proportion of liquid assets to demand and fixed deposits being over 66%. Rs. 1,90,87,145-10-0 in advances repayable on demand and Rs. 1,72,67,174-8-4 in cash credits and fixed loans were sound and fully secured. As regards industrial investments the Bank stood committed to Rs. 27,40,506 only after being adequately

1 Balance-sheet as at the end of 30th September, 1922.

2 Indian Central Banking Enquiry Committee, Vol. III, pp. 171-72.

written down. These consisted of the Bank's holdings in the following companies[1] :—

1. The British Italian Corporation, London, to the shares of which the Tata Bank had subscribed in common with the leading London Banks a sum of £10,000 which stood in the Bank's books as Rs. 1,10,000.

2. The Industrial Finance, Ltd., which was formed to show separately the extent of the Bank's industrial holdings and the holdings of the Bank in such companies as the Nira Valley Sugar Co., Ltd., the New India Assurance Co., Ltd., and the Tata Power Co., Ltd., which had not yet reached a dividend-paying stage had been transferred to this company. The shares of all these companies held by the Bank except those of the Assurance Co., and the Power Company were fully paid.

3. The Tata Iron and Steel Company (Second Preference).

4. The Bombay Electric Supply and Tramways Co., Ltd.

There was a tremendous uproar at the Tata Bank meeting held in May, 1923, where the management was severely criticised by the shareholders. The desirability of abandoning industrial business and of returning to normal banking was stressed by several shareholders as it would be more conducive to their interest.[2] At two extraordinary general meetings of the Bank held on the 19th July and 6th August, 1923, resolutions were passed for an amalgamation of the Bank with the Central Bank of India. The Bank went into voluntary liquidation on the 6th August, 1923, to give effect to these resolutions. Thus ended prematurely the career of the Bank on which the limelight had played ever since its establishment four years before.

Whatever might have been in the minds of its promoters, the Bank was far from a well-conceived industrial bank. The activities of the German banks in the industrial field in their earlier stages had made a profound appeal to the founders and

[1] Circular issued by the Tata Bank to its shareholders, dated 7th May, 1923.
[2] *The Capital*, May 10, 1923, p. 1100.

they wanted to transplant the German model on Indian soil. But evidently they had not the slightest notion as to the way in which German banking was actually conducted in relation to German industry. The union of commercial banking with investment trust business followed by the German banks in their early career was only seen but the fundamental principles adopted by them in industrial financing were never known nor understood. It has already been shown in an earlier chapter that although the German banks in the beginning had combined the two functions, they had, as a rule, employed their long-term funds only in industrial investments. Their enormous paid-up capital and the debentures which they frequently issued were the main source out of which their industrial business was conducted. The short-term deposits were seldom, if ever, used for such purpose. But in the case of the Tata Bank, long-term credit business was not only combined with ordinary banking transactions as in the case of the earlier German banks but the long-term operations were unfortunately financed out of current and annual deposits. The Bank never made any attempt to issue debentures for financing such operations. The same neglect to issue debentures for financing long-term transactions had in an earlier period led to the downfall of the French Credit Mobilier, the prototype of all industrial banks. The union of short-term banking with long-term investments under these circumstances leads to one and only one result—disaster. Again, in marked contrast with the policy of the German banks, the expressed object of the Tata Bank was to retain permanently a considerable holding of shares in the companies in which the Bank was interested. It will be recalled that permanent participation in industry had never been the deliberate policy of the banks in Germany. The pursuit of such a policy by the Tata Bank naturally entangled considerable amounts of its funds in doubtful concerns. The investments of the Bank were neither carefully planned nor wisely selected. It appears that neither the merits of the industrial propositions taken up by it were properly tested nor the value of the security offered carefully

assessed. The consequence was that the Bank embarked upon industrial ventures which had no reasonable prospects of success and were quite unsound. The Nira Valley Sugar Co., which was floated by the Bank and soon proved a failure, is a case in point.[1] A great deal of the success of a banking concern conceived on these lines depends upon efficient management and organisation. The ignorance and inexperience of the management of the Tata Bank must have hastened the crisis. It was never realised that such an institution should proceed slowly, gradually and with caution and should never be anxious to show large profits in the earlier years. The same anxiety to achieve a rapid success had to no small extent been responsible for the unhappy fate of the Credit Mobilier.[2] It was the European employers who chiefly controlled the affairs of the Bank. The rights of the Indians were ignored and this naturally alienated their sympathy and the management became unpopular.[3]

The other institutions of the period bearing the same ambitious title of "industrial banks" were started in close imitation of the Tata Bank. A perusal of their memoranda and articles of association shows that they intended to pursue every variety of ordinary banking business and couple with it issue, investment trust and real estate mortgage business.[4] Whatever might have been in the minds of the original promoters of these banks, the institutions remained content with the conduct of more prosaic commercial banking business and at no stage of their short career undertook any significant industrial financing. A glance at the balance sheets of these so-called industrial banks clearly shows a preponderance of deposit, discount and short-term business. The direct investments in industrials were insignificant. According to the balance-sheet

1 Indian Central Banking Enquiry Committee, Vol. III, p. 8; pp. 171-72.

2 See Chapter IX, *Infra*.

3 B. T. Thakur, *Organisation of Indian Banking*, p. 35.

4 See Memorandum of Association of the Calcutta Industrial Bank, filed 25th September, 1919. Also Memorandum of Association of the Indian Industrial Bank, Ltd.

for example of the Indian Industrial Bank, dated 31st December, 1922, its investments consisted of Rs. 49,669-12-0 in 6% War Bonds and only Rs. 2,661 in shares and stocks; while the balance sheet of the Calcutta Industrial Bank, dated 31st December, 1921, shows no such industrial investments at all. The loans made by the banks usually included those advanced to firms in which a director was interested as a partner and in a good many cases those that were quite unsecured. Every description of banking was undertaken and very little regard was paid to basic principles of commercial or investment banking. The management was even more inefficient and inexperienced than in the case of the Tata Bank. Short-loan banking was mixed up with long-term credit business even more indiscreetly. The pet concerns of the director's were heavily financed, without judging their soundness or financial standing. Large loans were taken by directors who had no intention of repaying them at all. The consequences were felt soon enough. After a hectic career lasting for 3 or 4 years, most of the banks were caught in the post-war slump and disappeared quickly.

No useful conclusions regarding industrial banks could be drawn from the experience of 1917-19. To call these institutions, which had neither the experience nor the knowledge nor even the equipment for industrial financing, "industrial banks" would be entirely misconceiving the true nature of such institutions. To say that the experiment in industrial banking failed and urge it as a ground for opposing the establishment of specialist institutions for financing industries, well-equipped, well-managed and conceived truly on scientific lines—would be a gross misrepresentation of things. Industrial banks, it has been aptly put, in their true sense have been as rare as snakes in Iceland. They have never been in existence, although strangely enough many started with that title and some still retain it even to-day.[1]

[1] *Indian Finance*, Banking Number, 1929, p. 51.

The question of Indian joint-stock banks taking a part in the provision of long-term finance was discussed at length before the last Central Banking Enquiry Committee. The Committee concluded that in connection with the issue of shares and debentures of industrial companies, such of the existing commercial banks as were well established and carried on their ordinary banking business on the safest and soundest lines might with advantage to the industries follow as far as possible the German system, the Imperial Bank making a start in this direction and giving a lead as soon as the Reserve Bank was formed. Ten per cent. of the total capital and reserves of the Imperial Bank and nine other big joint-stock banks might be utilised in this manner.[1] The advantages and dangers of a drift of commercial banks into the investment field have been sufficiently stressed in a previous chapter.[2] The main conclusions reached there are applicable to the Indian commercial banks. In following an industrial policy the banks should work under a close network of restrictions, distributing carefully and cautiously the risks of their investments, choosing highgrade and easily marketable industrial bonds for their investment portfolio but never intending to hold them permanently and avoiding real estate loans as far as possible. Bonds running from three to five years might be issued, as has been done by some Swiss banks, to raise the necessary funds for their less liquid investments. The formation of security affiliates on American lines by Indian banks cannot be recommended owing to the inherent danger of such practice which was clearly brought out during the recent American crisis.[3]

Local Banks and Loan Offices in Industrial Financing:

Although the Imperial Bank and other Indian joint-stock banks have generally avoided investments in industry, local

[1] Indian Central Banking Enquiry Committee, Vol. I, Part I (Majority Report), pp 296-97.

[2] See Ch. IV.

[3] See Ch. IV.

banks and loan offices play a part in the long-term financing of industry by advancing loans against mortgage of block. The tea industry of Bengal and Assam has been financed in this way. Some local banks have indeed made a speciality of financing the tea industry and in that respect bear close analogy to the "trade banks" of the Continent. The most prominent among these "trade banks" have been the Jalpaiguri Banking and Trading Corporation and the Lakshmi Bank. They make advances against mortgage of tea gardens and appurtenances and also on the security of tea shares. In 1931 the Jalpaiguri Banking and Trading Corporation made, for instance, loans against mortgage of gardens amounting to Rs. 11,60,000 at rates of interest varying from 9 to 12%. Loans on the security of tea shares amounted to Rs. 1,78,000. There were further unsecured loans to the extent of Rs. 5,57,000 at a rate of interest not exceeding 12%[1]. These Jalpaiguri tea banks, however, operate with a very small amount of paid-up share capital. The Banking and Trading Corporation was established with a paid-up capital of Rs. 50,000 only. The bulk of the necessary funds is obtained from fixed deposits running for two years, one year and six months, the rates of interest being 7%, 6½% and 4½%, respectively. In the recent depression these tea banks, as is usual with such trade banks which have their fortunes bound up with one particular industry, have been hit very hard. A considerable portion of their loans to the tea industry has become unrealisable and frozen and some of them have closed their doors. Besides these specialised banks in Jalpaiguri, there are several other loan offices in Bengal and Assam which finance the capital expenditure of tea gardens. The balance-sheets of several tea companies show that loans against mortgage of fixed assets were received from the Brahmanbaria Loan Company, the Manickgunge Loan Office, the Pabna Bank, etc.[2] The Tezpore Industrial Bank

1 Balance-sheet of the Jalpaiguri Banking and Trading Corporation, December 31 1931.

2 The Brahmanbaria Loan Co. lent on mortgage on the Chotolekha to the Indian Tea and Commerce, Ltd., Rs. 44,219-10-0 at 10% per annum; and the Pabna Bank also lent on

has been financing the block expenditure of a number of tea gardens in Assam since 1920. Its first loan to the tea industry was a sum of Rs. 20,000 advanced to the Panbari Tea Company on the mortgage of the garden. Loans on block account were made to several other concerns of which the Nirmala and the Radhanagar may be mentioned. The interest for these loans varied from 10 to 11%.[1] The same fate as that of the Jalpaiguri banks has overtaken these offices. Most of the tea gardens in the recent crisis were unable to repay their debts and the banks have been compelled to restrict their assistance to temporary accommodation for meeting current expenses.

Problems of Current Finance for Indian Industry :

The need for working capital arises from the fact that an interval of time occurs between expenditure on production and realisation from sale. During this period the manufacturer has to incur considerable expenses for payment of wages, purchase of raw material and stores, marketing of finished products, etc. In India the capital raised by industry from public subscriptions is more often than not entirely exhausted in setting up the factory with the necessary equipment and nothing is left for meeting working expenses. The industry has to seek this working finance from outside sources. But this can usually be secured with the greatest difficulty and on the most onerous terms.

The amount of working capital required varies from industry to industry and may be reckoned at a value of about six to eight months' output in normal times.[2] It forms again about 20 to 30% of the total block capital of a business. In the sugar industry the Tariff Board has estimated the working capital required to be

mortgage to the Hindusthan Tea and Fishery Co., Ltd.—Balance-sheets of the tea companies concerned for the year ending 31st December, 1929.

1 Evidence of the Managing Director, Tezpore Industrial Bank, Assam Provincial Banking Enquiry Committee, Vol. II (Evidence), pp. 383-86.

2 Report of the Indian Tariff Board, Paper and Pulp Industry, p. 52.

approximately one-third of the season's output.[1] With production at 117,000 maunds per annum and works cost at Rs. 7-8-5, the working capital. will be Rs. 3 lakhs. In industries like cement and paper, larger amounts are required for working capital, the sums often running to 12 and even 15 lakhs of rupees for each factory. In the Tata Iron and Steel Industry, working capital required is about two and a half to three crores.[2] There are very few cases where an industry has been able to provide a substantial amount out of its share capital for working capital in addition to block. Two notable instances may be quoted where working capital was provided from the start out of paid-up share capital, the Okaha and the United Cement Companies (each having a capital of 32 lakhs).[3]

Banks and the Financing of Current Expenditure :

Among the banks the Imperial Bank plays the most important part in the provision of current finance to industry. The Central Bank of India, the Bank of India, the Bank of Baroda and a few other Indian joint-stock banks also have a share in furnishing their current finance. The exchange banks generally concern themselves with the financing of foreign trade and the part played by them in the matter of providing finance for the current requirements of industry is insignificant. They consider that this is not essentially a real part of their business.[4] To a small extent they provide such finance to industries generally under European control.[5]

The principal directions in which the Imperial Bank renders financial assistance to industry are by (1) discounting bills, (2) advancing loans and (3) granting cash credits. Many industries

[1] Report of the Indian Tariff Board on the Sugar Industry, p. 67.

[2] Statutory Enquiry into the Steel Industry, 1926, Vol. II, p. 310.

[3] Oral Evidence of Bombay Shareholders' Association, Indian Tariff Board (Cotton Textile Industry), 1932, Vol. V, p. 81

[4] Evidence of the Representatives of the Exchange Bankers' Association, Indian Central Banking Enquiry Committee, Vol. III, p. 331.

[5] Indian Central Banking Enquiry Committee, Vol. II, p. 530.

have got clear overdrafts whilst advances have been made on government securities to several others.[1] By far the greater part of the advances to industrial concerns is on the hypothecation of stocks. Advances are also made against the pledge of stocks.[2] When the Imperial Bank opens a cash credit account in favour of an industrial concern, it requires a promissory note with two signatures on every loan. The second name on the promissory note is called the guarantor. In a joint-stock company, it is usually that of the managing agents. The loan is further secured by hypothecation of stocks of raw and manufactured goods which is demanded in addition to the two signatures. The Imperial Bank cannot lend except on two signatures because under the Imperial Bank Act of 1920, hypothecation is no security. It is merely an additional collateral security. The pro-note does not give a specific claim. The payment of the note may be demanded but no particular asset may be attached. When the Bank gets the signature of the joint-stock company and the managing agents as well as the hypothecation of stocks, it has a specific claim to the extent of the stocks and a general claim on the entire wealth of the joint-stock company and the managing agents.[3] The other Indian joint-stock banks generally follow the Imperial Bank and demand the additional guarantee besides hypothecation of stocks. Thus in the cotton mill industry, banks seldom lend on the promissory note of the mill, company alone but usually insist on an additional guarantee from the managing agents even though the stocks are hypothecated. If the stocks are pledged to the bank with its name on the godown, it does not generally demand the personal guarantee of the managing agents. But mills do not like to pledge the stocks, if they can avoid it. Under the peculiar circumstances in which cotton mills

1 *Oral Evidence of* Mr. (now Sir) K. M. Macdonald, Managing Governor of the Imperial Bank of India, Indian Central Banking Enquiry Committee, Vol. III, p. 869.

2 *Ibid*, p. 902.

3 Evidence of Mr. (now Sir) K. M. Macdonald, Indian Central Banking Enquiry Commitee, Vol. II, p. 889.

are financed in India, pledging of stocks is considered to lower their prestige and to entail many inconveniences and disabilities. The stocks of cotton and cloth when hypothecated are stored in the godowns of the mills to which the banks are given access whenever they desire it. The borrower furnishes weekly or monthly returns of stocks to the banks.[1] The banks do not press for the control of the stores and other liquid assets when the mill's financial position is sound and the guarantee of the managing agents has been obtained. But they press for control and depute a man to keep watch when the mills are in difficulties or when they have not obtained two signatures.[2] These loans and cash credits are made for 12 months with liberty of renewal. The rates for such advances vary according to the credit and standing of the mills. For well-established firms the interest on bank loans is the prevailing bank rate and if the mill is not sound, it has to pay 1 or 2% more. In case of cash credits banks sometimes insist on the "half interest" clause under which the borrower has to pay to the bank interest on at least half the amount of cash credit, irrespective of the amount drawn. The system of half interest clause, though prevalent in Bombay and Indore, is unknown in Bengal.[3] In Bombay mills the usual margin allowed by the banks is 20 to 25% in the case of stocks of cotton and cloth in godowns and 40 to 45% for those in process. In Bengal the Imperial and other joint-stock banks advance, in the case of overdrafts against hypothecation of stocks, upto 60 to 75% of the value of the stock of goods in godowns and on stock in process.[4] The usual guarantee is of course required before any advance is made to the mill company. Stores and fuel when hypothecated are not taken into account so far as the

[1] Indian Central Banking Enquiry Committee, Vol. II, p. 388.

[2] Indian Tariff Board (Cotton Textile Industry), 1927, Vol. II, pp. 323-34.

[3] Letter to the writer from the managing agents of the Mohini Mills, Ltd., dated the 25th October, 1932.

Letter to the writer from the managing agents, Bengal Luxmi Cotton Mills, Ltd., dated the 8th March, 1938.

drawing power is concerned and are *treated as merely additional* security.

Banks do not, however, constitute the only or even the principal source of supply of working capital to industry. On the 1st of October, 1930, bank loans and cash credits for 64 Bombay mills amounted to 2·26 crores. On that date the total amount of finance required by them was 24·83 crores and this *particular source* supplied *only* 9% of the total. In Ahmedabad banking assistance to the cotton mill industry is of a far smaller amount than either in Bombay or in Calcutta. The mills there are *reluctant to* hypothecate their stocks to the banks and industry in this centre depends for its current finance almost entirely upon the managing agents and public deposits.

In recent years the Imperial Bank and other joint-stock banks have from time to time made advances to the Ahmedabad cotton mills against their liquid assets plus the additional guarantee of the agents, but the amounts are quite insignificant in relation to the large requirements of the industry.[1] Of the 1080 lakhs constituting the total finance required by 56 Ahmedabad mills, only 42 lakhs were obtained from this source. It was only 4% of the total as compared with 9% in the case of the Bombay mills.[2]

Public Deposits as a Source of Industrial Finance :

By far the most important source from which cotton mills both in Bombay and *Ahmedabad derive* their working capital is deposits received from the public. Ahmedabad mills, again depend on this source to a greater extent than their confreres in Bombay where the practice of bank loans and cash credits is comparatively more prevalent. These deposits are usually taken from indigenous bankers and other sections of the public for

1 Oral evidence of the *Ahmedabad* Millowners' Association, Indian Central Banking Enquiry Committee, Vol. II, p. 491.

2 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 278.

short periods of 6 or 12 months. The rates of interest payable on the half-yearly and yearly deposits vary according to the credit and stability of the mill company and its agents. In Bombay good mills with large reserves can get money on fixed deposits at rates of 4½% to 6½%. Some of the most well-reputed mills used to obtain the deposits not only at the same rates as quoted by banks but even at ½% lower.

In Ahmedabad, the deposits are obtained at rates varying from 4½% to 5½%.[1] The deposits here as in Bombay generally come from the individuals. Before the War, they used to come almost entirely from the public at large, the rural areas contributing a substantial amount. In recent years the practice of interdepositing on the part of the mills themselves has grown up in Ahmedabad. Instead of lending the surplus funds to a bank, a mill to-day deposits them with another mill, generally speaking, not of the same agency.

The system of obtaining large amounts of circulating capital by attraction of deposits is peculiar to the Bombay and Ahmedabad cotton mill industry but is not prevalent elsewhere. The practice does not obtain in Delhi or Madras. It is not also firmly established with the cotton mills in Bengal, though it is not entirely unknown there. The Mohini Mills, for instance, obtain some fixed deposits from the officers of the company as well as from the public.[2] The balance-sheet of the company for 31st December, 1933, shows that fixed deposits amounted to Rs. 1,02,221-10-3 and the other deposits were Rs. 2,08,079-15-0.[3] The Articles of Association and the managing agency agreement empower the agents to obtain deposits on behalf of the mill at 6%.[4] The Dhakeswari Cotton Mills, Ltd., also receives some

1 Oral Evidence of the Ahmedabad Millowners' Association, Indian Central Banking Enquiry Committee, Vol. III, p. 482.

2 Letter to the writer from the managing agents of the Mohini Mills, Ltd., dated the 25th Oct., 1932.

3 Balance-sheet of the Mohini Mills, Ltd., dated the 31st December, 1933.

4 Cl. 20 of Articles of Association of the Mohini Mills, Ltd.

deposits generally from mill employees and persons known to them. Almost all the employees keep their savings in the mill. These deposits, though said to be on savings account, are really on current account for they can be withdrawn more than once a week. Their total amount at one time was Rs. 2 lakhs and the rate of interest was $4\frac{1}{2}\%$.[1] We are not aware of any other Bengal mill obtaining deposits.

But this practice is only nominal. Very few people venture to deposit money in cotton mills in Bengal, and the mills also do not appear to be inviting deposits by offering attractive rates. These deposits, however, have been very popular in Bombay and Ahmedabad where cotton mills could attract large amounts very easily. The public had great confidence in the cotton mills and in many instances even preferred to deposit with the mills rather than with the government. Cases are not unknown where mills had to refuse deposits, so great was the inflow of funds at times. The Sholapur with a paid-up capital of Rs. 8 lakhs and the Swadeshi mills with a paid-up capital of Rs. 20 lakhs received at one time as deposits as much as Rs. 1·30 crores and Rs. 42 lakhs respectively.[2] In March, 1924, total unsecured loans (mostly in the form of deposits) amounted in the case of the Bombay mills to Rs. 11·9 crores. As a result of the recent depression, deposits have declined to some extent. But still on the 1st of October, 1930, the amount of deposits held by 64 mills in Bombay was Rs. 2·73 crores. Eleven per cent. of the total finance required was derived from this source alone.[3] The total deposits with the Ahmedabad mills have been estimated to be more than seven crores.[4] In 1930, 56 Ahmedabad mills had 4·26 crores which formed 39% of their total finance required.[5] The relative importance of

1 Source: The managing director, Dhakeswari Cotton Mills, Ltd.

2 Indian Central Banking Enquiry Committee, Vol. II, p. 387.

3 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p 278.

4 Evidence of Ahmedabad Millowners' Association, Indian Central Banking Enquiry Committee, Vol. III, p. 481.

5 Indian Central Banking Enquiry Committee, Vol. I, Part I, p.

deposits as a source of financing the cotton mill industry is obviously much greater than in Bombay.

The method of financing the cotton mills by means of deposits has been severely criticised as highly dangerous and full of drawbacks. There are indeed some inherent disadvantages in this system of financing. There may frequenly be a temptation of overtrading which unsecured loans generally give rise to. With money obtained at relatively low rates, mills may be prone to speculation in cotton and may be tempted to carry larger stocks than are justified by market conditions. There is also the risk that the short-term funds may be used for extension of plant and machinery—a practice which is sure to be fraught with disastrous consequences. Some mills indeed made the sad mistake of locking up the short-term funds in long-term credit transactions and they had to pay the inevitable penalties. There is another risk to which this system of financing is also exposed. Owing to a financial panic there may be a sudden and heavy withdrawal of deposits which is sure to prove a source of embarrassment to the mill companies. In times of heavy stocks, when the money is locked, the fixed deposits may not be easily repaid.

In ordinary times, however, this method of borrowing for current finance has some great advantages. If the deposits were not attracted, a big working capital would have to be provided. Under the system of deposits capital can be kept low relatively to assets and hence to productive and profit-earning capacity. As the rates of interest are fixed relatively low, the profits available to the shareholders enable the mills to pay higher dividends than would otherwise be the case. As regards the danger from a run by depositors, there were indeed a few cases where a run on mills by panic-stricken depositors led to the collapse of the concerns.[1] During the present depression also several Bombay mills have been put to great difficulties owing

[1] Indian Tariff Board (Cotton Textile Industry), 1927, Vol. IV, p 300.

to the withdrawal of deposits. But the danger in normal times is not so great as is often made out. The deposits are generally fixed and are spread all over the year. They will become due at various dates throughout the year. The possibility of an immediate demand for payments by all the depositors at a particular date which might precipitate a crisis is not very great. The system suits the cotton industry in Bombay and Ahmedabad admirably for supplementing the working capital. In the buying season when cotton has to be purchased, more money is required than towards the end of the year. The deposits are taken just at that time, say for six months, at rates of interest lower than one has to pay for the whole year round. These loans are repaid after six months when the cloth has been sold. The industry takes money where the money is easy but does not require it when it is getting tight.

The practice of financing cotton mills in Bombay and Ahmedabad out of deposits from the public bears some analogy to the system, prevailing for a long period in the Lancashire cotton spinning industry, of financing mills partly by loans made by depositors. The bulk of the fixed capital represented by buildings, machinery, and equipment was no doubt furnished by share and debenture capital but a portion was also obtained from deposits.[1] The depositors were mainly large numbers of mill operatives and local trades people who had been accustomed to invest their savings in this manner. When a cotton spinning mill was floated, a small amount of the capital was called up and the rest of the capital was usually raised by loans carrying interest at about 4% free of tax. The loans were unsecured and were withdrawable according to the amount at notice ranging from two weeks to three months.[2] This method of finance doubtless enabled the mills to be built and run cheaply while very little of the loan money was ever lost. Under modern conditions, however, the Balfour Committee pointed out, the system

1 Final Report of the Balfour Committee on Industry and Trade, p. 43.

2 *Ibid*, p. 46.

"presents great dangers, since it is contrary to the principle of sound finance to use loans repayable at short notice for the purpose of fixed capital." During the recent prolonged depression when the mills had to call up the unpaid share capital, the shareholders, who were required to meet these calls, were forced in many cases to withdraw their loans from the same or other mills and these caused serious disturbances in the finances of the mills.[1]

In India, although a number of concerns have foundered on the rock of financing through deposits, cotton mills under prudent and conservative management have been immensely benefited. It may not be the soundest *system of financing the* mills but it would hardly be fair or reasonable to condemn this method of financing categorically when it has stood the test of time during the last 30 or 40 years. As the present facilities for banking assistance to industry are, the system has filled a real need in India. It will also be incorrect to suggest that the finance is all short term. As has been pointed out by Mr. Kasturbhai, Chairman of the Ahmedabad Millowners' Association, yearly deposits form 95 to 98% of the finance employed by Ahmedabad mills. They are taken not at a particular period but for all the year round, and run for 12 months, so that if any mill company is in difficulties and funds begin to be withdrawn, it does not get a notice of a week or a fortnight or a month but practically gets 6, 8, or 9 months to arrange for finance and so settle upon a fixed basis.[2] In recent years, ordinary deposits have not as a rule been invested in the block account of the mills, seven-year deposits being invariably employed for these purposes. Whatever may be the merits of debenture finance, it is clear that Indian industry has been able to escape the depressing influence exerted by this method of financing on

1 Survey of Textile Industry (Committee on Industry and Trade), p. 36. Also Further Factors in Industrial Efficiency (Committee on Industry and Trade), pp. 175-76.

2 Indian Tariff Board (Cotton Textile Industry), 1932, Vol. IV, p. 116.

industrial earnings which has been so marked a feature of European industrial finance in the recent years of depression.[1]

Deficiencies in Banking Assistance to Indian Industry :

The conditions and terms under which Indian industry is able to obtain banking assistance appear to be rather onerous. The practice of requiring two signatures is an essential part of the present banking structure of the country. The second signature is seldom dispensed with. It is required even when a regular pledge is given, even when the banks are in physical possession of the liquid assets. The statement of the representative of the Imperial Bank before the Central Banking Enquiry Committee that the Bank takes the second signature only when the stock is not pledged does not appear to be consistent with facts.[2] The advances by the banks to industry are much better secured here than in the western countries because the personal guarantee of the managing agents is obtained, besides the regular securities. But from the view point of industry, the insistence on the second signature from the managing agents serves to restrict the total amount of finance it can raise. The actual amount of advance is far too small relatively to what the assets will justify, and is generally less than what the concern requires for its purpose.[3] Cash credit is available generally to big industries such as jute and cotton. The Imperial Bank advances only when the industry is well established. No facilities are available in the early stages. Besides, the facilities given in the form of cash credits are withdrawable at any moment. The attitude of banks to industrial concerns which have issued debentures has already been noticed. Their credit with the banks is weakened and their shares

1 *The World Economic Survey*, League of Nations, 1932-33.

2 See the remark of the President, Indian Tariff Board (Cotton Textile Industry), 1932, Vol. V, p. 81.

3 Article by Mr. Manu Subedar in the *Indian Finance*, Banking Number.

become unacceptable as collateral and they find it extremely difficult to raise the loans and cash credits on the usual terms. Such penalization is unwarranted and is dictated by a narrow banking policy.

There is an undercurrent of feeling that the Imperial Bank has been very harsh in its dealings with Indian industrial concerns and has in many instances withdrawn credit in such a manner as to force their liquidation. A number of witnesses appearing before the Indian Central Banking Enquiry Committee accused the Bank of unsympathetic treatment and even of racial discrimination.[1] But there is scarcely any ground for this feeling against the Bank. As regards the charge of racial discrimination it is interesting to note that the witnesses failed to substantiate the charge and were not prepared to quote concrete cases even in camera.[2] It was with them only an impression that Indians of sufficient standing were not able to get the same financial help from the Bank as a European would. We have, on the contrary, the testimony of Mr. (now Sir) H. Mody that the Imperial Bank could never be accused of racial discrimination,[2] so far as the cotton industry of Bombay was concerned. The witnesses were also forced to admit that in those few cases where withdrawal of credit was alleged to bring about the ruin, the position of the concerns did not warrant the continuance of any further assistance.[3]

Although there has been no complaint against the Imperial Bank so far as the financing of cotton mills in Bombay on the system of hypothecation is concerned, it has come in for a good deal of criticism in regard to its attitude towards the Indian section of the tea industry in Bengal. The Imperial Bank does not lend direct to the tea companies on crop hypothecation because it is precluded by the Act of 1920 to advance against such securities alone and as usual insists on an additional

[1] Indian Central Banking Enquiry Committee, Vol. II, p 468

[2] Indian Central Banking Enquiry Committee, Vol. III, p. 468.

[3] *Ibid.*, Vol. III, p. 421.

guarantee. But the guarantors whom the Imperial Banl generally approve of are European firms of managing agents and the four European firms of tea brokers through whom all tea has to be sold. As a rule, the Imperial Bank does not lend on the guarantee of Indian managing agents or the "tea banks" of Jalpaiguri.[1] A reference to the proceedings of the Bengal Provincial and the Central Banking Enquiry Committees discloses that a specific charge was made against the Bank that it had refused to lend on crop hypothecation to some Indian-owned gardens inspite of the guarantee offered by the Jalpaiguri Banking and Trading Corporation. There was a definite suggestion that the Bank was confining its acceptance of guarantors to European firms only and thereby putting the Indian gardens to a great deal of inconvenience. In reply to the questionnaire of the Bengal Provincial Banking Enquiry Committee, the Imperial Bank denied the allegation and stated that it was solely guided by the status of the firm proposed as guarantor.[2] The Central Banking Enquiry Committee pursued the point with the managing governor of the Bank. He was specifically questioned as to whether the Bank could provide the necessary finance to the tea gardens on the guarantee of the Jalpaipuri Banking and Trading Corporation just as it did on that of the European brokers or managing agents. The reply was that the Bank was always prepared to finance tea gardens on the guarantee of a third party and that any application for accommodation would be dealt with on its own merits.[3] The reply of the Bank in both cases appears to be evasive. There is an undercurrent of feeling that few Indian companies obtain the finance they require from the Bank.

The Imperial Bank might have been precluded by statute

[1] Letter from the Secretary, Indian Tea Planters' Association, *Indian Central Banking Enquiry Committee, Vol. II*, p. 660.

[2] *Minutes of Evidence*, Bengal Provincial Banking Enquiry Committee, Vol II.

[3] Evidence of Mr. (now Sir) K. M. Macdonald, Managing Governor, Imperial Bank of India, Indian Central Banking Enquiry Committee, Vol. III, p. 25.

to lend simply against hypothecation without any additional guarantee. But the attitude of the other banks which follow suit is inexplicable. Such a system of financing industry has no parallel in any other part of the civilised world.

The insistence on the part of several banks for taking physical possession of the stocks when they agree to grant loans against hypothecation is a source of great inconvenience to Indian industry, particularly to the cotton mills of Bombay and Ahmedabad. The concerns are required to store the goods in the godowns of the banks under the control of the latter. In some cases the goods are allowed to be stored in the company's godowns with the board of the bank affixed outside. The general circumstances and the standing of the parties are so entirely different from those prevalent elsewhere—the majority of the cotton mills having to work here upon a system of public deposits—that the acceptance of such conditions is believed to prejudice their position in the eyes of their creditors.[1]

The practice of charging a rate of interest 1 to 2% higher than the Imperial Bank rate with a certain minimum (in Bengal cotton mills 7%) for the accommodation furnished by banks must have acted as a drag on Indian industry. The average bank rate is generally much higher in this country than in England or Japan and the demand of more than 1% over it here must be almost in the nature of a penal charge. For a number of years, for instance, the prevailing bank rate in India had been very high. From November, 1929 to April, 1930, it stood at 7%. In 1931 the average rate for the whole year worked out at 7.046%. The high bank rate must mean high interest rates to be borne by Indian companies for their current finance. The Bombay mill industry, for, example, had in October, 1930, Rs. 7·58 crores as loans from banks and managing agents on which

[1] The Bombay Shareholders' Association: Replies to the Tariff Board questionnaire (Cotton Textile Industry Enquiry), 1932.

interest at or above the prevailing high bank rate had to be paid. It was a heavy burden that the industy had to bear.[1]

The insistence by several banks on the "half interest clause" in the western side of the country is an additional drawback from which the cotton mill industry of Bombay specially suffers. Interest has frequently to be paid on half the credit allowed whether the provision has been utilised or not. This is probably not very unreasonable as the bank is obliged to provide the full amount of the cash credit whenever demanded. But at the same time it is clear that much of the benefit from cash credit is reduced as the mills will naturally tend to pay them back, *long before they* are due, to avoid the payment of interest.

Complaints against inadequacy of banking assistance and of hard dealings on the part of banks have increased in number and in frequency during the recent years of depression and have been made even with respect to the Bombay mill industry where they have been rare so long. There is a kind of widely held impression that the Imperial Bank, not to speak of other banks, has not been doing its duty these years to the premier industry in its distress. It has drastically reduced its loans and cash credits and has even refused its accommodation to several mills, although there were the usual margin and the agents' guarantee.[2] In many cases borrowing mills have been put to unnecessary trouble and interference by other banks. The rates charged for advances have also been increased. First class mills are now paying 1 to ½% more than they used to pay in the pre-war days. When the banks in England have firmly stood by the British cotton mill industry and the Central Bank itself is playing a large part in its reorganisation, it is unfortunate that the banks in our country should be indifferent to the premier national industry in the times of stress and strain through which it has

1 Representation of the Bombay Millowners' Association to the Indian Tariff Board (Cotton Textile Industry), 1932, dated the 31st May, 1932, p. 41.

2 Memorandum of Mr. A. D. Shroff, Indian Central Banking Enquiry Committee, Vol. II, p. 383.

been passing. There is not only a general reluctance to provide financial assistance but even a marked tendency in several cases to exact rates of interest which can hardly be called fair.[1] The position of Bengal mills has been rendered particularly difficult, for they have not, like their *confrères* in Bombay and Ahmedabad, an alternative source of finance in public deposits. A number of cotton mills have informed us that they experience great difficulties in securing the finance from banks. There is a general feeling that facilities for borrowing working capital are not available in Bengal.[2]

The principal source from which current finance is obtained for the Bombay and Ahmedabad mills has been depleted seriously in recent years. The public are largely withdrawing their deposits. The world-wide trade depression is no doubt responsible for a considerable portion of the withdrawals but there is reason to believe that the higher rates of interest obtainable by purchasing treasury bills, gilt-edged securities and postal cash certificates have diverted large amounts of deposits to these channels of investment. New deposits that might have otherwise flown into the mills have also been drawn away into these investments. The mills are experiencing considerable difficulty in obtaining their required working capital from deposits and have been forced to offer higher rates of interest to attract them. The plight of the Bombay mills has been much worse in this respect. The confidence of the depositors had already been shaken in them on account of large losses and failures brought about by industrial troubles and the present heavy withdrawals have aggravated their distress. The mills in Ahmedabad have also been hit but there the decline in deposits from rural areas and other sections of the public has been partly compensated

[1] The Bombay Shareholders' Association: Replies to the Tariff Board questionnaire (Textile Industry Enquiry), 1932.

[2] The Managing Agents, the Mohini Mills, Ltd., the Mahaluxmi Mills, Ltd., and the Luxmi Narayan Mills, Ltd.

for by the recent growth of interdeposits by the mills themselves as noticed above.

Suggestions for Improving Facilities of Current Finance :

The restrictions imposed upon the working of the Imperial Bank under the Act of 1920 stood in its way of providing adequate financial facilities for Indian industries. The fact that hypothecation was no security under the Act and the Bank had to demand an additional guarantee from managing agents hitherto caused a great deal of hardship to borrowing concerns. On the passing of the Reserve Bank Act of 1934, and the consequent amendment of the Imperial Bank Act, the Bank has been freed from some of the restrictions which had existed so long on its working. Under the amending Act of 1934 the Bank has been authorised to advance directly against goods hypothecated to it subject to the special directions of the Central Board, instead of being restricted to advances only against goods which are in its possession or the documents of title which are deposited with it.[1] If the additional guarantee of managing agents is dispensed with, the handicap from which borrowing concerns suffer to-day owing to the insistence of the guarantee will be removed. It will be interesting to know how far the present banking practice will be modified in the direction of dispensing with the agents' guarantee. The writer approached in this connection the Managing Director of the Imperial Bank but beyond confirming that the Bank was empowered to lend directly against the hypothecation of goods, he furnished no more information.[2] It is to be hoped that the Imperial Bank will make a liberal use of the powers granted to it under the amendment and dispense as far as possible with the necessity of the agents' guarantee. The Indian joint-stock banks which had hitherto followed the Imperial

1 See Schedule I, Part I (IVa), Sec. 15(1) of the Imperial Bank of India (Amendment) Act, 1934.

2 Letter to the writer from the Managing Director, Imperial Bank of India, dated the 20th March, 1936.

Bank in demanding the guarantee should now reconsider their policy in view of the amendment of the Imperial Bank Act. The system of cash credits adopted by the Imperial and other banks is not sufficiently elastic, and should be replaced as far as possible by the system of discounting bills. The popularisation of commercial bills is sure to increase the facilities for short-term industrial credit. A more extended use of commercial bills, it is interesting to note, has also been advocated by the Macmillan Committee for the benefit of English industry.[1] In recent years bills in England have largely gone into disuse and there is an increasing tendency to conduct business on seasonal overdrafts with the banks rather than the bill between the manufacturer and the customer.

The establishment of large warehouse companies is also likely to mitigate the drawback from which Indian industry suffers to-day on account of the insistence by the banks on a high margin for their advances against stocks. These could take over the stocks, keep them in their own warehouses and banks might safely advance against the warehouse receipts or warrants. The system under which goods are kept to-day under lock and key of the banks without affording suitable facilities for sale would then be abolished and the present arbitrary methods of valuation by banks would also be dispensed with.

A great deal of the difficulties regarding the supply of current finance for Indian industry is undoubtedly due to the prevalent idea that banks should furnish the whole of the required working capital. Sound methods of financing industry presuppose that an industrial concern should not only meet its fixed capital expenditure out of share capital but that at least some portion of the working capital should also be provided out of it. The failure to realise this has been a source of great embarrassment for many a newly established concern. Banks

1 Report of the Committee on Finance and Industry, p. 169.

cannot conceivably finance a buisiness until it has worked for some time.

In the western countries in recent years there has been a remarkable tendency among industrial companies to pursue a conservative dividend policy and to meet their working capital expenditure out of profits or from the sale of securities.[1] Resort to bank borrowing is made only in emergencies and they have been growing more and more independent of banks as regards the supply of their working capital. It may be recalled that this trend in industrial financing has deprived the banks there of the ordinary avenues of employing their funds.[2] Indian concerns should curb their almost universal tendency of distributing excessive dividends and try to build up large reserves which may with advantage be utilised for meeting their working capital expenditure. A well-known cotton mill in Bengal which in the earlier years of its development was severely handicapped for want of adequate financial facilities for current expenditure has been for a long time now financing its working capital expenditure out of undivided profits and reserves and has dispensed with the necessity of bank loans and cash credits.[3]

1 E. S. Mead, *Corporation Finance*, New York, 1933, p. 319.

2 See Chapter IV, *Supra*.

The Managing Director, Dhakeswari Cotton Mills, Ltd.

CHAPTER VI.

Managing Agents in the Rôle of the Industrial Financier in India[1]

The Managing Agency System forms the basic frame-work of the existing methods of industrial finance in the country. It has no counterpart in any other part of the world and is entirely peculiar to India. She does not possess the industrial banking system of the Continent. Nor are there institutions in the country, corresponding to the issue houses, investment bankers and under-writing firms of the Western countries. Their place in the financing of industries is taken in India by the Managing Agency System, an effective substitute for all of them. It is India's unique contribution to the institutional developments of industrial finance.

It is not the place here to conduct a research into the origin of the Managing Agency System. It is generally believed that the inception of the Managing Agency System dates back to the days of the old East India Company.[2] The "agency houses" of those days later blossomed into the European firms of Managing Agents of the modern times. The device was originally adopted to ensure the supply of foreign capital for industrial ventures in India. The same device was later on found to be highly useful for attracting investment of Indian capital in indigenous enterprises.[3] Whatever might be the way in which

[1] The substance of this chapter was published in the form of an article in the *Calcutta Review*, September and October, 1937.

[2] J. B. Richards (American Trade Commissioner in India), Special Report No. 37, January, 1933. Also K. C. Mahindra of Messrs. Martin & Co. in the *Indian Finance*, dated July 13 and 20, 1929.

[3] "The Managing Agency System—the problem in relation to Indian Industrial Development"—an article in the *Indian Finance*, July 13 and 20, 1929.

the system originated, it is firmly implanted in the industrial organisation of India to-day. Ever since its inception, it has been closely associated with the industrial development of the country. Even now when an industrial company has to be floated, it is almost invariably the practice to connect it with an existing house of Managing Agents or create a new Agency to look after it when started.

Managing agencies generally come into existence on the occasion of the promotion of a joint-stock company. There is no company promoter in India in the same sense as in England. His place, as already noted, is taken by the managing agent here. A group of persons, a syndicate or a firm of managing agents take the initiative in floating a company. They undertake all the risks and bear all the initial expenses of experiment and research. The enterprise cannot be launched before the public and the latter cannot be invited to subscribe to its capital unless and until the promoters are definitely assured that it is a really workable proposition. Even when the promoters are perfectly satisfied that the promotion may be made profitable, an intermediate stage, that of a private company, follows before the public are finally asked to put their money in the venture. The private company may be carried on for sometime till it may be brought to the profit-earning stage. It is then considered ready for offer to the public. All the preliminaries have by this time been completed, a good deal of spade-work done and a routine established. The company can now safely be launched upon the public. In the West the promoter is rewarded by the grant of cash or the allocation of some shares in the company. Here the promoters are rewarded by being entrusted with the managing agency of the concerns in creating which they have incurred such risk and trouble and expenditure. Thus the managing agency of Tata Sons, Ltd., was created with reference to the Tata Iron and Steel Co., the Indian Cement Co., and the Tata Hydro-Electric Co. In the West the promoter ceases to take any interest in the venture as soon as the promotion is completed.

He is only interested in a successful issue and prosperity or adversity of the business in later years is entirely a matter of indifference to him. But the managing agents here remain closely associated with the business they have promoted for a fairly long period, and their interests become identified with those of the company. Here their activities are comparable not to those of the English company promoter but are reminiscent of the practice of German banks in the earlier years. Like them the managing agents have played an important part in nourishing the enterprises they have promoted. They have stood by them in their young and immature stage, attending to their financial needs and ministering to their ailments in every phase of their development.

Managing agency firms are chiefly partnerships or private limited companies. Proprietary firms or public limited companies are not unknown but the partnership agency firms predominate. Of the 36 firms of managing agents in Calcutta, only 7 are limited companies, all the rest being partnerships. Most of these limited companies, again, were originally partnerships which have subsequently been converted. Messrs. Andrew Yule & Co., Ltd., furnishes a typical instance where a partnership has been converted into a private limited company. The private limited managing agency companies are generally nothing but family firms that have converted themselves into such companies to take advantage of the limited liability afforded by the Companies Act.

The managing agency firms may thus be described as either partnerships or private limited companies, formed by a group of individuals with strong financial resources and considerable business enterprise.[1] They do the preliminary work of research and experiment, precedent to the starting of new concerns, promote joint-stock companies, employ their own funds for financing the requirements of the concerns in their group or

arrange for such finance by acting as guarantors and as the name implies manage their business.[1] Besides the promoting, financing and managing of industrial concerns, a number of other functions usually called " subsidiary services " have come to be associated with them. They act as agents for marketing the produce of their companies and also for purchasing their requirements of raw materials, store and machinery. In addition to all this, the larger and more important among these firms, especially in the Calcutta side, conduct a great variety of business, such as export and import trade, banking and various kinds of agency business.[2] The activities of one well-known firm of managing agents in Calcutta are found to be carried on in as many as 15 different departments.[3]

Calcutta is the home of the managing agency. It is here that the system first originated. But as the utility of the system came to be perceived, it spread over to other industrial centres such as Bombay, Ahmedabad, Madras and Cawnpore. The greatest development of the system has, however, been reached in Calcutta, Bombay and Ahmedabad. In Bombay and Ahmedabad the managing agency firms are mostly Indian and the system is associated chiefly with one kind of industry—the cotton mill industry. In a few instances only the management of more than one kind of business may be observed. The most notable instance in this respect is that of the Tatas who are interested in iron and steel, cotton, hydro-electric and cement industries. But in Calcutta the important agency firms are mainly European and they are connected with a variety of enterprises.

The constitution of the managing agency is slightly different in the three industrial centres—Bombay, Ahmedabad and Cal-

1 Panandikar, *Banking in India*, p. 215.

2 Evidence of Bengal Chamber of Commerce, Indian Central Banking Enquiry Committee, Vol. III, p. 384.

3 *Thacker's Indian Directory*, 1935, pp. 30-31.

cutta. The chief distinguishing feature is that the managing agency is permanent and hereditary invariably in Ahmedabad and in some instances in Bombay but not so in Calcutta. The big European managing agency firms in Calcutta have so many more partners—they numbered fourteen in the case of Barry & Co. in 1935 [1]—than the managing agency firms in the other two centres that there is not the same scope here to capture a managing agency and keep it going on in the family. But an attempt is always made to bring into the business an outside element carrying with it industrial experience or technical knowledge or even some capital. Some of the Senior Assistants are in this manner frequently made partners of the firm, when an opening is created for them by the retirement of the senior or other partners. Numerous instances can be quoted to show that the assistants of the past have become partners, even senior partners of to-day. On the retirement of the partners they are not neeessarily succeeded by their sons or nephews but frequently by other assistants. It is often found that a member of the founder's family, a son or a nephew, does not automatically become a partner of the firm but serves as an assistant in the firm. Sometimes but not invariably he becomes a partner after acquiring sufficient experience or technical knowledge. Thus although the firm may have some representatives of the founder's family, the presence of so many other partners in it obviates any possible degeneration due to family succession.[2]

Functions of the Managing Agents :

The Managing Agent fulfils three important functions in the industrial economy of India. He combines in him the functions at once of the *entrepreneur*, the capitalist and the business manager. As an *entrepreneur*, the managing agents have taken upon themselves all the risks and responsibilities of pioneering

1 *Thacker's Indian Directory* 1935.

2 Evidence, Bengal Chamber of Commerce, Indian Tariff Board (Cotton Textile Industry), 1927, Vol. III (Evidences), p. 322

new industries in a country where industrial development had scarcely been significant. As Mr. Mahindra has observed, the managing agents have led the way for a systematic industrial advance in the country. "Their courage and faith to conduct preliminary experiment and research, their ability and willingness to furnish the necessary finances, their sporting preparedness to face all risks and above all their vision and unerring instinct to perceive the commercial possibilities of a project" have achieved for India a substantial measure of industrial progress. All the more important jute mills, cotton mills, tea gardens and the greater part of sugar factories, electric supply companies and light railways were established and are still managed by them. The iron and steel industry and the hydro-electric industry would never have reached their present stage without the enterprise of the Tatas, their managing agents. A number of other prosperous and flourishing industries of to-day would have yet been in the womb of future without the initiative of managing agents. They were the pioneers in the field of industry in the country and have borne all the losses of pioneer industrialism.

Managing Agents in the Rôle of the Industrial Financier

The attribute of the managing agent that has most attracted public attention is his rôle as a capitalist, the supplier of industrial finance. Sir Victor Sassoon described the arrangement of finance for the companies under his control as the most valuable function of the managing agent.[1] The provision of finance not only for initial fixed capital expenditure but also for subsequent reorganisation, extensions and modernisation as well as for working capital purposes has to be arranged for by the managing agents. They furnish this finance in various ways : by themselves subscribing to the share capital and debentures of joint-stock companies or getting them subscribed by their friends and relatives, by arranging loans from banks and pledging their guarantee for the

1 Indian Currency Commission, 1926, Vol V, Q. 5008-9.

loans, by attracting deposits from the public on the strength of their reputation and standing in the business world and last but not least by making advances to their companies from their own private resources at certain agreed rates of interest. Not only do the managing agents themselves subscribe to the shares and debentures of the companies they manage but they assist in the placing of their securities on the market as the underwriters or issue houses of the West or the "industrial banks" of the Continent do. They thus perform the useful function of bringing together the investor and the company.

The part played by managing agents as an industrial financier has been so important and has aroused so much public interest that it is worth while to examine in some detail the various forms in which they have rendered this financial assistance to industry. The provision of fixed initial capital to industry by means of subscription to its share capital is the most important element in industrial financing and it will be interesting to investigate to what extent managing agents furnish initial capital to industry in this form. So far as the Ahmedabad cotton mill industry is concerned, the claim of managing agents that they provide fixed initial capital by means of subscription to share capital is in the main justified. Mr. Kasturbhai Lalbhai, representing the Millowners' Association in Ahmedabad, stated before the Tariff Board of 1932 that in several cases managing agents then held 3/5ths of the shares in the cotton mills. There were even individual cases where 85 to 90% of the shares were owned by them.[1] As regards the Bombay mills, a careful perusal of the evidences tendered before the Tariff Boards of 1927 and 1932 gives one the impression that the managing agents were the majority shareholders.[2] The managing agents of the Bengal cotton mills have not the same large stake in their companies as their confreres in Ahmedabad and Bombay. Still they have a fair amount of shareholdings.

[1] Evidence of the Ahmedabad Millowners' Association, Indian Tariff Board (Cotton Textile Industry), 1932, Vol IV, p. 189.

[2] Indian Tariff Board (Cotton Textile Industry), 1927, Vol. IV, p. 248.

For instance, in the Bengal Luxmi the managing agents hold 25% of the share capital, in the Mahaluxmi 10% and in the Mohini 5%.[1] In the case of the recently started Basanti Mills, there appears to be an exception for here the managing agents with their relatives and friends own nearly 80% of the share capital.[2] Four of the partners of the managing agency firm along with one relative are found to hold 25,000 shares out of a total of 51,980 shares taken up.[3]

It will be interesting to investigate the position in this respect in the jute mills under the Calcutta firms of managing agents. We have studied the Summaries of Capital and Lists of Shareholders of a considerable number of jute mill companies. The shares are not always held in the name of the managing agency firm. They are often held in the name of the various partners of the firm and sometimes in the name of their wives and daughters and even other relatives. The share registers, however, do not always give a definite idea on account of the system of blank transfer which is prevalent in Calcutta but not in Bombay. The shares held in the name of a managing agency firm and its partners may be considerably more or less than the number indicated in the register because some shares may be held on blank transfer. It will, therefore, be somewhat difficult for us to make any statement on the extent of the managing agents' shareholdings.

Although it may be difficult to obtain an estimate of the exact amount of shares held by managing agents in a company, a fair index of the extent of their holdings may be had from a study of the Summaries of Capital and Lists of Shareholders in two different periods, the one in the year after the incorporation of the company when the first list was filed and the other in the present times. An estimate of the extent of the agents' holdings in the first period based on the amounts as given in the

1 Letters to the writer from the Managing Agents of the mills concerned in reply to his questionnaires.

2 Prospectus of the Basanti Mills, Ltd.

3 *Summary of Capital and Lists of Shareholders* made up to the 3rd November, 1934.

earliest lists of shareholders is not likely to be vitiated very much by the practice of blank transfer. The transfer and re-transfer of shares must have begun later. A comparison of the extent of shareholdings at the two different periods will also assist us to discover any possible tendency among the agents to reduce their holdings and dispose of the same to the investing public. A careful examination of the Summaries of Capital and Lists of Shareholders filed with the Registrar of Joint-Stock Companies, Calcutta, at the two different periods has given the following results :—

Name of Jute Co.	Year.	Total number of shares.	No. of shares held by Managing Agents.	Percentage of total capital held by Manging Agents.
(1) The Auckland Jute Mills, Ltd.[1] (Messrs. Bird & Co.)	1909	20,000	426	2·1
	1934	30,000	735	2·4
(2) The Kankinarrah Jute Mills, Ltd [2] (Messrs. Jardine Skinner & Co.)	1883	14,000	3,885	27·7
	1935	40.000	4,605	11·5
(3) The Hooghly Jute Mills, Ltd.[3] (Messrs. Gillanders Arbuthnot & Co.)	1914	1,59,600	20,655	12·9
	1935	1,59 600	9,069	5·6
(4) The Naihati Jute Mills Co., Ltd.[4] (Messrs. Heilgers & Co.)	1906	11,000	1,125	10·2
	1934	17,500	155	·8
(5) The Kelvin Jute Co., Ltd.[5] (Messrs. Mcleod & Co.)	1908	16,000	1,518	9·4
	1935	17,000	75	·4

There is a practice with some Calcutta agency firms to own subsidiary companies which play a part in the financing of the concerns under the management of the parent companies. In

[1] Summaries of Capital and Lists of Shareholders made up to 29th June, 1909 and up to 11th May, 1934.

[2] Summaries of Capital and Lists of Shareholders made up to 31st December, 1883 and up to 15th February, 1935.

[3] Summaries of Capital and Lists of Shareholders made up to 3rd August, 1914 and up to 21st June, 1935.

[4] Summaries of Capital and Lists of Shareholders made up to 2nd April 1906 and up to 24th November, 1934.

[5] Summaries of Capital and Lists of Shareholders made up to 26th August, 1908 and up to 18th April 1935.

forming an estimate of the extent of the managing agents' share-holding in a concern, the amounts held by such subsidiary companies will have to be taken into consideration. The Calcutta Discount Company, a subsidiary of Messrs Andrew Yule & Co., Ltd., and the Strand Properties, Ltd., a subsidiary of Messrs. Mackinnon Mackenzie & Co., are two typical instances.

The foregoing study of some representative lists of share-holders makes it fairly clear that the European managing agents in the case of the Calcutta jute mills have seldom contributed any considerable portion of their initial fixed capital. In a few cases they have no doubt subscribed to the share capital of the companies under their management to some extent. But there is a general tendency with them not to hold the shares permanently but to dispose of them to the investing public as soon as possible. This is evident from the examination we have made of the position in the two periods—the one immediately after the mills were started and the other in the present times. In many cases where the agents held some shares in the beginning, they have gradually unloaded them among the public to such an extent that their holdings have become quite insignificant. Thus they are truly underwriting firms, holding very few shares in their companies, always endeavouring to pass them on to the public whenever possible. The managing agency system presents in this respect a sharp contrast to that prevailing in the cotton mills of Bombay and Ahmedabad. The tradition in Calcutta is altogether different. The agents themselves have an entirely different conception of their functions in this respect. They take a pride in disposing of issues to the public and they consider themselves highly successful agents if they are able to dispose of the whole issue in this manner. If people have faith in the managing agents, they will be anxious to buy the shares in the concerns under their management. It is obvious the greater the reputation of the managing agents, the greater will be the inducement to invest in the companies promoted by them and the managing agents under such circumstances will be

left with very few shares in their hands. Mr. K. C. Mahindra observed before the Tariff Board of 1932 that his firm, the Martins, did not hold even 20% of the shares of the companies under their managing agency because they prided themselves on the fact that they were successful agents.[1] The nearer a concern can be brought to the point where the agent has to hold the smallest possible percentage of the share capital, the more successful will the agent be called. Like the Bombay and the Ahmedabad agents they are not inclined to lock up their resources by holding shares in their own portfolio but they take the earliest opportunity to free their funds from the shareholdings in a company so that the same might be made available for the benefit of another company. It is only when public floatation proves a "frost" that managing agents are left with a large number of shares. The public, for example, may subscribe only 20% of the capital and 80% may be lept in the hands of the managing agents in the beginning. Managing agents under such circumstances do not close down the concern but devote themselves earnestly to the task of showing to the public that the company would work well.[2] After a few years when they have been able to show for the company, a good record, the proposition becomes attractive to the public who had previously shunned it and the shares are quickly disposed of. Here again the managing agents fulfil their functions as intermediaries between the company and the investors. Their shareholdings at the start are never voluntary and at the earliest opportunity they are sold out. This aspect of their activity may very usefully be compared to similar functions performed by the industrial banks of Germany in the investment field.

As regards the position in the cotton mills of Bombay to-day the statement that the majority of the shares in the different mill companies are held by managing agents is also debatable. Ever

[1] Evidence of Mr. K. C. Mahindra of Messrs. Martin & Co., Indian Tariff Board Cotton Textile Industry), 1932, Vol. V, p. 57.

[2] Letter from Messrs. Martin & Co., 14th Sept., 1932. Memorandum of Notes by Mr. K. C. Mahindra, Indian Tariff Board (Cotton Textile Industry), 1932, Vol. III, p. 247.

since the cotton mill industry was caught in the post-war depression, managing agents have been steadily unloading the shares on the stock exchange. Their holdings have in many instances been severely reduced. Mr. J. J. Kapadia made certain investigations into the lists of shareholders of a number of companies at the office of the Registrar of Joint-stock Companies, Bombay, and found that in the case of some mills the agents' holdings were insignificant. In one instance 6,000 shares were divided among 500 persons of which the managing agents held only 83. In another case out of 4,000 preference shares, 2,863 shares stood in the name of a Maharajah and out of 7,500 ordinary shares, the number of shareholders was 800, the managing agents holding only 341 shares.[1] Whatever might have been the position in the earlier years, the managing agents are not to-day the principal shareholders in the Bombay cotton mill industry. Their holdings are in many cases a small fraction of the total capital and frequently less than those of single individual holders. In the Bradbury Mills, for instance, the managing agents, Messrs. Currimbhoy Ebrahim & Sons, Ltd., held 624 shares including 40 in the name of Sir J. Currimbhoy out of a total of 4,000 ordinary and 6,000 preference shares or 6·2%. In the Kasturchand Mills the agents also held 624 shares only out of a total of 9,600 shares or 6·5%.

The question of the stake of managing agents in the concerns under their control has aroused a great deal of interest. A comparatively heavy stake in the enterprise by means of shareholdings has generally been considered highly desirable. The more substantial the interest of the managing agents in the share capital of the company, the more ensured the identity of interest between the agent and the company. It has often been suggested that they should have a statutory holding of at least 25%; as high a percentage as 60% has been advocated. The

1 Oral Evidence of Bombay Shareholders' Association, Indian Tariff Board (Cotton Textile Industry), 1932, Vol. V, p. 110.

anxiety is always there to safeguard the interests of the shareholders. If the agents' holdings are insignificant, say 10%, or even less, there might conceivably be a sort of divergence of interest between the agent and the company. His financial stake in the industry is nil and he will not be induced to manage it carefully and efficiently. The absence of practically any shareholdings by managing agents in Calcutta in the concerns under their management may from this point of view be a source of grave anxiety to the shareholders. There have actually been cases where efficiency of management has varied with the interests of managing agents in their respective concerns. A well-known firm of European managing agents controlling a large number of jute mills only a few years ago met with severe criticisms in the hands of shareholders who complained that the agents' holdings in the companies under their managements were only $1\frac{3}{4}\%$ of the total capital and this was responsible for the fact that the jute companies under these particular managing agents were not making any profits. While admitting the desirability of managing agents having a substantial stake in the enterprise, it must be pointed out that the shareholders' interests will not be jeopardised if the agents regard their connection with the company not merely from the viewpoint of commercial interest but as a matter involving their reputation. Under such circumstances the question of the stake will naturally be shorn of much of the importance which is frequently attached to it. As the Tariff Board have rightly pointed out in their Report (1932), "Where the managing agent represents a high standard of ability and sense of responsibility, it may make little difference to the company to what extent the managing agent is interested in the share capital of the company. The better class of managing agent works partly for the remuneration fixed for him under his agreement but partly also out of regard for his reputation and out of a sense of pride in the tradition of management associated with his concern."[1] It should

[1] Report of the Indian Tariff Board regarding the grant of protection to the Cotton Textile Industry, 1932, p. 86.

also be remembered that when the managing agents' holdings are preponderant, the rest of the shareholders have very little effective voice in the management of the company whose control remains entirely with the managing agents. Indeed where the management is not efficient, the holding of a considerable portion of the share capital by the managing agent may be fraught with disastrous consequences for the company. In some quarters there has even been a strong feeling to restrict the managing agent's holdings to a definite percentage of the shares of the company.[1]

From the foregoing study, it is clear that although the managing agents have in some cases participated in the share capital of industrial companies, any suggestion that they are singly the most important or largest shareholders will be, with a few exceptions, incorrect and misleading, at least in the present times. Contrary to general belief, it appears that their contribution to fixed initial capital by way of subscription to shares has not been considerable. The managing agents have, however, contributed to fixed capital expenditure in another form. For the purpose of financing schemes of extension and reorganisation in the concerns under their management they have frequently furnished long-term loans or have taken up debentures in large amounts. The importance of this aspect of the managing agents' rôle as an industrial financier can hardly be over-estimated in a country where there is no organisation which can furnish loans against the fixed assets of industry or where debentures are not as popular a method of investment as in the West. In the case of the Bombay cotton mills where figures for managing agents' holdings of debentures are available, it is found that Rs. 45·5 lakhs out of a total debenture issue of Rs. 238 lakhs were taken up by them.[2] In the recent years of unusual difficulty they spent not less than Rs. 75 lakhs there in the matter of new equipment.[3]

1 See Legislative Assembly Debates, Vol. VI, No. 8 (9th Sept., 1936), p. 733.

2 Indian Central Banking Enquiry Committee, Vol. I, Part I (Majority Report), p. 278.

3 Speech of Mr. (now Sir) H. Mody, Legislative Assembly Debates, March, 1930, Vol. III, pp. 1756-57.

During the development period or during a period of depression when banks would not advance money or the public would not take up debentures, they have rendered considerable financial assistance. There are some industries which require quite a number of years before they become profitable. For the first seven, eight or ten years no profits are earned and they require careful nursing during this development period. The tea industry is a case in point. Tea gardens become paying propositions in at least the sixth or seventh year. A considerable amount of expenditure has to be incurred without any return during this period of development. The industry is nursed by managing agents during all these barren years. Very few tea-companies in India can, on the strength of their share capital alone, stop liquidation. Electricity supply companies are another form of industry which require at least in this country a pretty large number of years before they can show profits. The advances and guarantees of managing agents running frequently to several lakhs of rupees serve to sustain the struggling concerns during this period. A firm of managing agents financing such companies at Bhagalpore, Muzaffarpore, Cuttack, Mirzapur and Mangalore advanced and guaranteed in this way 12 lakhs of rupees. They would have certainly gone into liquidation without the financial assistance of their managing agents.[1]

There are indeed numerous instances where the managing agents have saved enterprises from ruin by timely loans and subscription to debentures. A company for the production of aeroplane spirit in Bengal, the pioneer company in this line in India, which was started in 1918 with a capital of Rs. 12 lakhs was saved from liquidation in 1923 by the financial assistance of managing agents to the extent of Rs. 17 lakhs. The company is paying to-day a dividend of 8%.[2] The Paper Pulp Company started in 1919 showed a debit of nearly 16 lakhs for the first 9

1 Legislative Assembly Debates (Sir N. N. Sircar's speech), Vol. VI, No. 9, p. 807.

2 Legislative Assembly Debates (Sir L. Hudson' Speech), Vol. VII, No. 7.

years. The advances made by managing agents fluctuated between Rs. 15 to 25 lakhs. The Kumardhubi Engineering Works obtained from time to time loans from their managing agents amounting to Rs. 22¾ lakhs. Without this finance they could not carry on. [1]

During a general crisis or depression in a particular industry managing agents have similarly lent their financial assistance and saved many industries from certain ruin. In the difficult years of 1920-21 when the banks would not advance money, the managing agents of seven Indian tea garden companies advanced Rs. 7 lakhs to help them through the slump. Five of them have already recovered to a dividend-paying stage.[2] In another instance, in the case of a company whose works are situated in Northern India, the managing agents made unsecured advances to the extent of Rs. 28 lakhs in 1923 and in the next year took up nearly 24½ lakhs of a debenture issue of 25 lakhs when the debentures could not be sold owing to a lack of confidence in the company. The concern is in a very sound position to-day.[3] In many cases managing agents in their efforts to keep up struggling concerns during a series of disastrous years continued making unsecured advances and increasing their financial risk and in the end nearly lost their all. The managing agents of Britannia Engineering Company lost in this way 5 lakhs, of Russa Engineering Company 7 lakhs, of Indian Tanneries 26½ lakhs, of Satikdih Coal Company 2½ lakhs and so on.[4] Had not the managing agents retrieved the companies by their steady and persistent nursing at considerable sacrifice through all the barren years of their existence, they would have been forced into liquidation, many a valuable industry would have been lost to the country and the shareholders would have lost their all.

1 (Sir N. N. Sircar's Speech), Vol. VI, No. 9, pp. 806-7.
2 *Ibid.* (Sir L. Hudson's speech), Vol. VII, No. 7, p. 1762.
3 *Ibid.*
4 *Ibid.*, Vol. VI, No. 109.

Another important form of financial assistance rendered by managing agents has been the provision of working funds for industry. In Bombay and Ahmedabad they attract enormous deposits from the public for financing the current expenditure of cotton mills. As a result of the recent depression the deposits have no doubt declined but in the years before the depression, the total amount was considerable. In March, 1924, total unsecured loans, mostly in the form of deposits, amounted in the case of Bombay Mills to Rs. 11·9 crores. Even on the 1st of October, 1930, the deposits held by 64 mills in Bombay were Rs. 2·73 crores. Eleven per cent. of the total finance required was derived from this source alone. The total deposits in the Ahmedabad Mills have been estimated to be more than 7 crores.[1]

It is the financial standing and reputation of the managing agents that have served to draw such enormous funds into the mill industry. Not only do the managing agents attract deposits in this manner but they have also to furnish the working funds themselves. The amounts loaned by managing agents to the Bombay and Ahmedabad cotton mills totalled in October, 1930, Rs. 5·32 crores and 2·6 crores, respectively. These formed 21% and 24% of the total finance required by the mills while bank loans formed only 9% and 4%.[2] This gives an idea of the preponderating nature of the financial assistance rendered by managing agents. Provisions are sometimes expressly inserted in the managing agency agreement itself that the agents will be under an obligation to furnish the working funds to the company at an agreed rate of interest.[3] In Calcutta, where managing agents are not interested in the share capital of their companies to the same extent as in Bombay and Ahmedabad and where deposits are not in vogue, industrial finance is provided by them to a great extent in the form of loans on current account. The

[1] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 278; also Vol. III, p. 481.

[2] *Ibid.*, p. 278.

[3] Cl. 22, Managing Agency Agreement, The Mohini Mills, Ltd.

balance-sheets of a large number of jute mills indicate the enormous amounts due to managing agents in this way.

Besides attracting deposits and assisting industry directly by furnishing their own funds, the managing agents render invaluable financial assistance in an indirect manner as they arrange for and have to give their guarantee for all the bank loans, cash credits and overdrafts required by the industrial concerns under their management. The Imperial Bank of India and following it the other commercial banks as well are unwilling to lend current finance on the promissory note of the industrial company against the hypothecation of its liquid assets. They insist on an additional guarantee from the managing agents. This guarantee is sometimes not dispensed with even when a regular pledge is given and the banks are in physical possession of the goods. The practice of requiring two signatures is an essential part of the present banking structure of the country. Under the circumstances industry cannot raise its working finance from the banks without the help of the managing agents. Bank loans do not indeed form a considerable portion of the total working finances of the Bombay cotton mill industry and they play a still less important part in the financing of the Ahmedabad mill industry. But whatever banking assistance has been secured, has been done with the help of the managing agents' guarantee. In Calcutta and elsewhere where the system of financing current expenditure by attracting deposits is not prevalent, industry has to depend to a far greater extent on banking assistance. The Managing Agents here are almost indispensable in securing for industry its current finance. There is, however, a slight difference with the practice in Bombay. In Calcutta the managing agents in many cases have not to give their personal guarantee as in Bombay, but they merely give a guarantee that the overdrafts granted are always covered by stocks.[1]

1 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 276.

The managing agent not only furnishes the necessary finances or arranges for them but by affixing his name to the prospectus of the company induces the investing public to come out with their purse for subscription to the capital of the concern. The affixing of his name to the prospectus means to the investors the setting of the seal of his approval to the enterprise and they are attracted by thousands towards the company. The well-regulated firms of managing agents have created a tradition and built up a reputation in the business world. The public have unbounded faith in such managing agents and do not make the slightest hesitation to put their savings in their hands. There has been in recent years a tendency to minimise the importance of the rôle played by managing agents as an industrial financier. The manging agent's power to attract capital has been doubted. But a glance at the pages of India's industrial history will at once reveal what an enormous hold good managing agency houses have over the investing public—what an attractive field of investment the businesses under their management have always been considered. They have never lacked the support of the investors and they have never failed to raise whatever finance they require. To mention only one instance, which is typical of well-reputed firms of managing agents: the Iron and Steel Industry under the managing agency of the Tatas. In the beginning it was believed that the enormous amount of money required for constructing and equipping a modern steel factory would not be found in the country and recourse was made to the London money market. But the London negotiations broke down and it was decided to appeal to the Indian investing public for financial support of the gigantic scheme.

The response was magnificent. The entire capital required for the construction works amounting to more than one and a half crore was subscribed at the end of three weeks only. An idea may be formed of what a tremendous rush there was for the shares from the graphic description given by Mr. Axel Sahlim, one of the consulting engineers of the Tatas, while

lecturing before the Staffordshire Iron and Steel Institute in 1912:—

"From early morning till late at night, the Tata offices in Bombay were besieged by an eager crowd of investors. Old and young, rich and poor, men and women, they came offering their mites and at the end of three weeks, the entire capital required for construction equipments, £1,650,000, was secured, every penny being contributed by some 8,000 Indians." [1]

The above account bears eloquent testimony to the trust and confidence which a good house of managing agents creates in the minds of the public. No better proof could be given of the power of managing agents to attract Indian capital to the hitherto untrodden paths of industrial investment.

The sugar industry is a more recent case in point. At a time when investors were holding aloof from capital investment all over the world, the sugar companies floated in India had never lacked their financial support. Their issued capital had been fully subscribed and even oversubscribed almost immediately after their flotation. This was principally due not only to the grant of protection but also to the fact that most of them had been established under the managing agency of very able and well-known firms. The raising of capital from the investing public would never have been so easy a matter if the companies were not floated under the ægies of firms in whose ability and financial standing they had immeasurable confidence.

We have made a special study of the lists of shareholders in the case of the jute mills under Calcutta firms of managing agents at the office of the Registrar of Joint-Stock Companies, Bengal. One fact of startling importance that at once leaps to the eye is the steady increase of financial stake of Indians in the jute mill industry. In the earliest stages of the development of the industry, scarcely an Indian owned a share in any of the

[1] Quoted in *The Capital*, Indian Industries, Trade and Transport Supplement, Dec., 1933, p. 46.

jute mills. Almost all the jute mill shares were held by Europeans and the names of one or two Indians only could sometimes be found among the lists of shareholders. Thus in the first Summary of Capital and List of Shareholders which was made up to 31st January, 1896, of the Albion Jute Mills Co., Ltd., the name of a single Indian could be seen. He owned only 25 ordinary and 25 preference shares out of a total of 6,000 ordinary and 5,000 preference shares of Rs. 100 each.[1] Even as late as the year 1909 we find the name of only one Indian as a shareholder in another jute mill, *viz.*, the Auckland Jute Co., Ltd. He held 160 shares only out of a total of 20,000 shares of the value of Rs. 100 each.[2] During the last 15 or 16 years a remarkable change has been taking place in the domicile of proprietory interests. Indianisation of jute mill stock has been proceeding rapidly and to-day more than 60% of the shares are held by Indians all over the country. The dispersion of proprietory interests which we have observed in the case of the jute mills is generally true of other businesses as well. This tendency of the notoriously shy Indian capital readily seeking investment in the jute mill and other industries clearly shows an abounding faith in the firms of managing agents which control them. The Indian investor would never have parted with his money unless he had believed that it was safe in the hands of the managing agents.

Managing agents have certainly created a feeling of trust and confidence which tends to encourage a steady flow of capital into industry. Indian industrial history abounds with numerous examples to show that a venture promoted by a well-reputed managing agency house is likely to attract public money more easily and quickly and to a larger extent than a similar venture under a managing director. In fact the system of managing agency has a far greater list of successes in the country than any

[1] Summary of Capital and List of Shareholders made up to 31st Jan., 1896—*The Albion Jute Mills, Ltd.*

[2] Summary of Capital and List of Shareholders made up to 29th June, 1909—*The Auckland Jute Co., Ltd.*

other system of management. And yet Mr. Manu Subedar in his Minority Report of the Indian Central Banking Enquiry Committee did not hesitate to observe, "The managing agency system tends not to encourage but to check the flow of capital in industry." Perhaps no other system would have been able to dispel the shadow of doubt and suspicion which tended to magnify in the eyes of the Indian investor normal risks in industrial investment to a most disproportionate extent. The supreme achievement of Managing Agency has been to draw Indian capital away from its traditional preference for land investments into the field of industrial participation.

Defects of the Managing Agency System of Finance—Inter-investment of Mill funds:

Although the managing agency system has rendered a very useful service to Indian industry by furnishing the necessary finances directly or indirectly, the system of financing by managing agents has been open to grave defects. In many cases they have pursued such unsound and questionable methods in financing industries under their control that the whole system of financing by managing agents has come to be regarded as unreliable, uncertain and unstable. The practice of inter-investment of funds by managing agents constitutes perhaps the most vital defect in this system of finance.

The surplus funds of one mill may sometimes be invested in the shares and debentures of another mill under the same managing agency. Funds raised on the credit of one concern may be lent to another under the same agents. There have been several cases in recent years where such a practice has been followed in the cotton mill industry. The balance-sheets of various cotton mills both in Bombay and Ahmedabad are dotted with records of loans and advances to companies in which the same agents are interested. The Nagpur, Swadeshi and Ahmedabad Advance Mills purchased in 1922 the debenture

issued by the Tata Mills under the same managing agency (Tata Sons, Ltd.) to the extent of Rs. 60,00,000 out of a total issue of Rs. 1,00,00,000. In 1927 the Fazulbhoy, Pearl, Crescent and Indian Bleaching Mills all under the agency of Messrs. Currimbhoy Ibrahim & Sons, Ltd., purchased shares of the Premier Mills under the same agents to the extent of Rs. 13,71,390. The balance-sheet of Sir Shapurji Broacha Mills for the year ending 31st March, 1924, shows an advance of Rs. 4,35,353-5-4 to the Indian Woollen Mills under the same agents (Messrs. Mathradas Gokuldas & Co.) and that of the Morarji Goculdas Mills for 30th June, 1925, shows a loan of Rs. 1,27,210-10-11 to the Dharamsi Morarji Woollen Mills under the same management. The balance-sheet of the Finlay Mills for 1926 discloses a loan of Rs. 5,50,000 to the Swan Mills under the same agents and that of the Gold Mohur Mills for 30th September, 1927, shows a loan of Rs. 3 lakhs from the Finlay Mills under the same agency.[1] Instances can easily be multiplied. Such a method of financing is highly questionable. There may be no evil consequences when the financial standing of both the mills is very good but the interests of the shareholders as well as the larger interests of the industry may be seriously prejudiced when the funds of a concern of a strong financial position are employed in financing a comparatively weaker one. Reserves of several well-established mills have in this manner been frittered away by lending them to others newly started by the same managing agents. When the new mills fell under evil days they dragged the old ones to liquidation along with them. This interlocking of interests often spells ruin even for financially sound concerns which have been tacked on to weaker sister concerns. It tends also to perpetuate quite wastefully the life of even thoroughly insolvent or unsound concerns which in the larger interests of the industry as a

[1] Representation to the Tariff Board, 1932, of the Bombay Shareholders' Association, dated 11th June, 1932.

whole should be immediately closed down.[1] A reference to the proceedings of the Tariff Board of 1927, conducting the cotton textile industry enquiry will show several instances where this practice of mixing up the funds of different concerns resulted in heavy losses and in the ultimate ruin of the better concerns in an attempt to save the weaker ones. The employment of the funds of the New Spinning Mill for financing the Haripur and the Ahmedabad Vepar Uttejak under the same management, the advances in the cases of the Saraspur, Edward and Srinagar Mills under the same agents and those in the case of the Whittle Mills (Broach), Asarva and Swadeshi Mills (Ahmedabad), Surat Industrial Mills, Viramgram Spinning and Manufacturing Company, Viramgram Alfred Mills Co. and Kulol Kapadia Mills, all under one agency—and the consequent heavy losses and liquidations are matters of record.[2] The practice is not so rare as was supposed by the Tariff Board of 1927 and during the last few years of depression it has tended to grow considerably.[3]

The practice is not entirely unknown in Calcutta. There are some managing agents who strictly adhere to the principle of refraining from lending the funds of one company to others under their control and management. In the Martins, for instance, there is no such practice. But we have come across some cases of Calcutta managing agents who have taken to the practice of inter-investing. The most notable instances in this connection are those of the India Jute Co., Ltd., and the Megna Mills Co., Ltd., and of the Gourepore Jute Co., Ltd., and the Nuddea Jute Mills, Ltd., all in the group which consists of Mackinnon Mackenzie & Co., Barry & Co., and Mcneill & Co. The Summary of Capital and List of Shareholders of the Megna Mills on 31st December, 1921, show that out of all 61,208 shares issued 50,000 were

1 Memorandum of Federation of Indian Chambers of Commerce and Industry to the Government of India regarding Amendments to Indian Companies' Act, Dec., 1934. See the *Indian Economist*, January 7, 1935, p 303.

2 Indian Tariff Board (Cotton Textile Industry), 1927, IV (Evidence), p. 410.

3 Report of the Indian Tariff Board (Cotton Textile Industry), 1932, p. 85.

held by the India Jute Co., Ltd.[1] The Megna was promoted in 1920 by the managing agents of the India Jute and the funds of the latter were invested in its share capital. Not only did the India Jute invest in the shares of the Megna but it had also been lending to it enormous funds ever since its establishment. On 30th September, 1922, the borrowings of the Megna from the India Jute stood at Rs. 65,52,000. At one time they touched the enormous figure of more than one crore of rupees.[2] The shares of the Megna have considerably depreciated in value, they were being quoted a few years ago at Rs. 22-8 per share while the nominal value was Rs. 40. It gives an idea of the enormous loss sustained by the promoting company which held, still in 1935, 40,540 ordinary shares in the Megna representing more than 50% of its share capital.[3]

The Directors' Report of the Gourepore Company, Ltd., a jute concern under Barry & Co., for the half-year ending 31st March, 1920, discloses a proposal for the payment of a bonus on ordinary capital at the rate of 400%[1] per annum by fully paid shares in the Nuddea Mills, Ltd., under the same managing agency, Rs. 24 lakhs were thus invested in the Nuddea shares.[4] The balance-sheets of the Gourepore show further investments in the 7% mortgage debenture loan of the Nuddea Mills. The Gourepore Jute is also found to have invested in the Gourepore Electric Supply Company, Ltd., under the same managing agency. In 1935 it held in the Electric Company 33,500 ordinary shares of Rs. 100 each.[5]

Another instance is furnished by the Alliance Jute Mills, Co., Ltd., which utilised 15 lakhs of rupees out of the undivided profits standing to the credit of its reserve fund in purchasing

1 Summary of Capital and List of Shareholders : The Megna Mills, Ltd , 13th Dec., 1921.

2 See Balance-sheets of the India Jute Co., Ltd., and Megna Mills, Ltd., from Sept., 1922 to Sept., 1935.

3 Jute Mills Review corrected up to 30th Sept., 1935. Ed. by H. P. Khandelwal.

4 Proceedings of the Ordinary Half-Yearly General Meeting of Shareholders held on 8th June, 1920.

5 Balance-sheet of the Gourepore Co., Ltd., dated 31st March, 1935.

150,000 shares of Rs. 10 each in the capital of the Waverley Jute Mills Co., Ltd., under the same managing agents, Begg Dunlop & Co.[1]

Cases of inter-investment of funds in other industries are also to be found. There is, however, a difference with the Bombay practice for in most of these cases the managing agents were authorised by Special Resolutions of shareholders in general meetings to make these investments. The acquisition of shares in sister companies under the managing agency by Special Resolutions of shareholders in general meetings is not entirely unknown in Bombay and Ahmedabad and, as far as it goes, is to be preferred to direct action on the part of the managing agents without the knowledge and previous consent of the shareholders. By a resolution of the company in general meeting, the Osman Shahi Mills under the agency of Messrs. Currimbhoy Ibrahim & Sons, purchased Rs. 12 lakhs worth of shares of the Azamjahi Mills under the same agency and the Raipur Manufacturing Company took shares of the value of 25 lakhs in the Arvind Mills in the managing agency of which its agents were interested. Any way, this is an unsound method of financing and is liable to be abused. It is satisfactory to note, however, that the Indian Companies Amendment Act of 1936 includes provisions which aim at a restriction of the practice.[2]

Other Defects of the Managing Agency System of Finance:

The number of companies under the control of a managing agency firm is sometimes so large that the strain on its financial resources becomes very great. It becomes impossible on its part to meet adequately the demands of the several concerns under its management. How heavy the financial strain may be is amply illustrated by the acquisition by the Currimbhoys of the agencies

[1] Return of Allotment on 28th October, 1916, of the Waverley Jute Mills, Ltd.

[2] Sec. 87 F.

of the Mathradas group of mills in 1923.[1] The difficulties are further accentuated by the entire absence of any practice among managing agency firms to work in joint co-operation or in Syndicates when financing industry on a large scale. Investment bankers all over the world have adopted this practice not only to solve the problem of financing which may be too big for any one of them singly but also to spread out the risks among the participants. These are not to be achieved under the Indian system of financing by managing agents.

Although the most important function of managing agents is to render financial assistance to industrial concerns under their *management, managing agency agreements seldom make it* obligatory for them to provide this assistance adequately. Elaborate provisions are found in the Articles of Association and the agreements themselves which stipulate that the managing agents will be entitled to charge and be paid by the companies interest, even with monthly rests, not only for all advances made by them but also for those made by the third parties, the repayment of which may have to be guaranteed by them.[2] But there is no reference to any obligation on their part to provide the requisite finance, or to any penalty in case they fail to do so, when required, on reasonable terms. The managing agency agreement of the Mohini Mills, Ltd., contains a clause to this effect. It is provided that the managing agents should remain obliged to advance up to Rs. 60,000 for carrying on the work of the mill if necessary at 7% interest, for which they will have the first charge on the movable and immovable property of the mill. If they fail to supply the money, they may be dismissed by the Directors and may even be required to compensate the mill company if it has suffered in any way owing to their

[1] Indian Companies Act: Case for Amendment. Representation of the Bombay Shareholders' Association to Government of India, p. 5.

[2] Art. 110, Articles of Association, 8th December, 1930. The Gourepore Electric Supply, Ltd.

inability to furnish the money.[1] This forms an exception and is not to be met with in the general run of agreements.

The absence of such provisions makes it easy for the managing agents to escape from and shirk the responsibilities of financing when the concern falls into bad times. In times of prosperity the funds may be advanced willingly and readily enough. But when a crisis envelops the industry or the particular concern is badly hit, the managing agents are either unable or unwilling to furnish the considerable amounts of money required. There are no doubt many cases where the agents have not failed to rise to the height of the occasion and have made magnificent sacrifices for their concerns. They have been known to put their private fortunes at the back of an industry and even to mortgage the ornaments of their women-folk to save it in a crisis. But there are many cases where the concerns have come to grief owing to the inability or unwillingness of managing agents to render necessary assistance. The real point is that the absence of any provision in the contract rendering it obligatory on the agents' part to provide adequate finance and the consequent immunity they enjoy on default has made the arrangement entirely one-sided and highly detrimental to the interests of the companies. The agents enjoy all the rights and emoluments pertaining to their office but are not under any contractual obligation to perform the main duty of their office—the provision of finance. It is unfortunate that the Indian Companies Amendment Act of 1936 which aims at a reform of the managing agency system contains no provision to this effect.

Trading and speculation by managing agents is another great defect. There are several instances, specially on the Bombay side, when the agents sustained considerable losses in share and cotton speculation. The consequent deterioration in the financial position of managing agents had undesirable repercussions on the mills themselves. Although the mills themselves were intrinsi-

1 Cl. 22 of the Managing Agency Agreement, The Mohini Mills, Ltd.

cally sound, banks withdrew their cash credits because the agents had become weak.

Some of the methods adopted by the managing agents in financing industry have been highly questionable. In a number of cases managing agents have turned their loans into debentures with the results that the concerns have passed into their hands and the shareholders have lost all their capital invested in them. Several instances may be quoted from Bombay. They are not unknown in Calcutta and during the war-end boom many such cases were heard. In the case of a well-known coal company the managing agents converted their loans into debentures and ultimately took possession.

The managing agency system rendered valuable services to Indian industries in the past. It has been in force in India in its present form for the last 60 or 70 years and without its help the industrial development of the country would never have reached its present stage. Finance is the life-blood of industrial growth and that finance has been made available for Indian industry through the system. Whenever the industries are in need of finance, whether for extensions and replacements of machinery or for current expenditure or even for initial block, it is the managing agents who have to furnish it themselves or make arrangements for it. The services rendered by managing agents in this connection have been very aptly compared to those rendered by the German banks to national industries.[1] In India where banking has developed on the lines of British commercial banking, which does not specially provide for industrial finance, industrial development would never have gone even as far as its present stage, if the managing agency system had not come into being. This system has fostered Indian industries in a way very similar to the industrial activities of the continental banks.[2]

[1] See Dr. Nemenyi's Evidence. Indian Central Banking Enquiry Committee, Vol. II, p. 303.

[2] Dr. Nemenyi's letter, dated 21st August, 1932, to the Indian Tariff Board (Cotton Textile Industry), 1932, Vol. III, p. 217.

But it must be admitted that there has been considerable degeneration of the managing agents in the present times. The good and well-established agency firms, whether Indian or European, have rendered invaluable services to Indian industry and its development and may still be of great advantage. But the modern managing agents, with a few exceptions, do not possess any of the characteristics of the old established houses. They do not possess the most important characteristic of managing agents, that of the ability to provide finance for the concerns under their control. Their limited resources and credit are much too inadequate for the purpose. The finance required for modern companies is so enormous that it is becoming increasingly difficult even for the older houses to assist the companies under their management. The burden has been in many instances too heavy to bear. The difficulties have been considerably aggravated by the fact that managing agents, unlike investment bankers elsewhere, have refrained from working in syndicates. This, it may be recalled, constitutes one of the gravest defects of the managing agency system of finance. The holdings of managing agents in the companies under their control have considerably diminished and in many instances are insignificant. A divergence of interest has naturally been created between the agents and their concerns. The absence of any obligation in the contract to supply finance on the part of the managing agents has rendered such a system of financing extremely unsteady and unreliable. The close sense of personal identity between the managing agent and his company which dominated the older houses and still actuates some of the well-established firms might have reduced the importance of this shortcoming. But it is fast disappearing and was even noticed by the Tariff Board of 1932.

Another quality which made the managing agency system so successful in the past was the efficiency of the agents based on their experience and technical knowledge. The new fangled managing agents have no knowledge of manufacture,—engineering, technical or scientific. They have no expert knowledge of

purchase nor of sales. Purchase agents are appointed at the cost of the company and sales are entrusted to ignorant wholesale agents who again are paid by the company. The various irregularities committed in filing balance-sheets, lists of shareholders, extraordinary resolutions with the Registrars of Joint-Stock Companies are an illuminating commentary on their knowledge of commercial law and training in secretarial work.[1]

Under the circumstances the financing of Indian enterprises should be made less dependent on the managing agency system than before. The possibilities of forming an organisation should be explored for supplying finance to Indian industries, specially that particular form of finance which has been the most important function of the managing agents to provide—*viz.*, finance during the development period and for extension and reorganisation. One of the main causes of the perpetuation of the managing agency system has been shown to be the policy of the Imperial Bank not to lend current finance to industry against the hypothecation of liquid assets only but to demand an additional guarantee from managing agents on the ground that hypothecation was no security under the Act of 1920. With the passing of the Imperial Bank Amendment Act of 1934, the Bank, as already noted, has been authorised to lend directly against the hypothecation of goods, subject to the direction of the Central Board.[2] Now that hypothecation is no mere additional collateral security as under the old Act, the additional guarantee of managing agents can be dispensed with by the Imperial Bank and following it by other banks as well. One of the main grounds, therefore, on which the existence of the managing agency system has been justified and has been sought to be perpetuated has lost much of its force to-day.

[1] Source: Registrar of Joint-Stock Companies, Bengal, at an interview.

[2] Letter to the writer from the Managing Director, Imperial Bank of India, dated 20th March, 1936.

CHAPTER VII

THE STATE IN THE RÔLE OF THE INDUSTRIAL FINANCIER IN INDIA

A study of industrial finance in India will not be complete without a reference to the part played by the State in the provision of financial assistance for the industries of the country. In the beginning of British rule in India, the industrial policy of the Government was buttressed by the English economic philosophy of laissez-faire, and it kept itself aloof from the indigenous industries. The Government at home subscribed to the same laissez-faire policy and used its influence to see that it was also adhered to in the case of India. As late as 1908, when an Industrial Conference was held at Ootacamund and a special officer was appointed by the Madras Government under the Director of Industries to control pioneer enterprises, Lord Morley promptly discountenanced these attempts of the Government. He believed that State effort should be strictly limited to industrial instruction and should avoid all semblance of a commercial venture.[1] Lord Crew who followed him as Secretary of State entertained the same belief as regards the futility of State trading on commercial lines but he had no objection to the purchase and maintenance of experimental plant by the Government. He was prepared to sanction the establishment of a Department of Industries. But even after Lord Crew's despatch the Government of India could not decide how far they would be justified in sanctioning proposals for financial and other forms of State-aid to industries.

In the meantime the Great War broke out and the exigencies of the circumstances brought about a new orientation as to the

[1] Despatch Number 50, *Revenue*, dated the 29th July, 1910.

ideas regarding the relations of Government and industry. Under the enormous stress of the war, the old doctrine of laissez-faire broke down. The theory that interference by the State in the economic life of the country was injurious to its well-being came to be discarded. Even Great Britain which was so long the citadel of laissez-faire policy adopted an active policy of encouraging home industries in various ways. In India, the Industrial Commission was appointed in 1916 and emphasised in its report the supreme importance of State-aid to indigenous industries. Besides suggesting various indirect forms in which the State could assist and encourage the Indian industries, the Commission recommended that the State should play a definite part in the financing of the small and cottage industries principally and also of the large-scale industries. As regards the latter, financial assistance rendered by the State, they recommended, should take the form of guarantees of dividends, of loans of money, of undertakings to purchase output or of subscription to share capital in certain cases where sufficient private capital was not forthcoming.[1] Circumstances in which such assistance might be given by the State should be cases where the starting of a new industry or improvement of an existing one was required to supply an existing deficiency in the interests of national safety, or where a new industry would have an important bearing on the economic development of the country or where the extension of an old industry to a new locality would benefit local consumers or producers.[2] Assistance to small or cottage industries should take the form of direct loans or of furnishing plant on the hire-purchase system.[3]

Before the publication of the report of the Industrial Commission, the interest which Provincial Governments had taken in the industrial development of the country was exceedingly meagre.

[1] Report of the Indian Industrial Commission (1916-1918), p. 184.

[2] *Ibid.*, p. 183.

[3] *Ibid*, p. 186.

A brief account may be given here of the efforts made in this direction by the Madras and United Provinces Governments. As early as 1898 the Department of Industries, Madras, attempted to pioneer the aluminium industry in India. In that year the Government sanctioned experiments at the School of Arts in working up sheet and ingot metal procured from the British Aluminium Co. In the course of six years a fairly large business in aluminium hollow-ware was developed and at the end of 1903 the Government thought that the time had arrived when private enterprise could be left to carry on the business unaided. The government plant and stock were sold to the Indian Aluminium Co., for a lump sum which left the Government with a clear profit of Rs. 30,000 on their experiment. The success of their first attempt at pioneering led the Madras Government to conduct experiments in developing chrome tanning and improved methods of weaving. As regards the chrome process of manufacturing leather, the efforts were highly successful. The chrome leather industry is now firmly established in India and the pioneering efforts of the Madras Government were undoubtedly responsible for it at least to some extent. The capital expenditure of the Government in this connection was Rs. 69,596 distributed among land, buildings, machinery and improvements. In 1910 the Government withdrew from the venture and sold the plant to the Rewah State for a sum of Rs. 50,000. The Department of Industries also made attempts to manufacture pencils and glass but here they were not so successful. In 1914 arrangements were made by the Government to utilise the machineries of the two defunct pencil factories at Anakapalle and Bimlipatam. In the same year the Government also obtained the factory and plant of a glass manufacturing company which had been started in 1909 with a capital of Rs. 2,00,000 but had subsequently gone into liquidation.

The Government of the United Provinces also took some interest in the industrial development of the province. A Conference was held at Nainital in 1907 by Sir John Hewett, the

Lieutenant-Governor of the United Provinces. Following the recommendations of the Conference, the Government extended financial assistance by loans and grants to several concerns, especially to sugar factories. The Government, for instance, in their letter No. 43C, dated 25th March, 1912, requested the Government of India for permission to sanction a grant of Rs. 30,000 to a sugar factory in Pillibhit owned by Raja Rai Lalta Prasad Bahadur. It was the first central factory in the province instituted and managed by Indian enterprise. Although there had been some losses, the enterprise proved to be highly instructive. From the point of view of sugar cultivation and also as an object lesson to other sugar manufacturers, it was desirable to assist the concern. The proposed grant was sanctioned by the Government of India in April, 1912.[1] The grant was made on the condition that the firm would spend a larger sum in introducing the requisite machinery into their factory and would be reconstructed under the supervision of the sugar engineer. There was no condition of repayment—it was an out and out grant. In their letter No. 1661, dated the 23rd August, 1912, the United Provinces Government again approached the Government of India with a request for sanctioning the grant of a loan of Rs. 7 lakhs to another central sugar factory, *viz.*, the Babhnauli concern situated in the Gorakhpur District. The proprietors, Messrs. J. Macdonald, G. R Macdonald and Farquhar Mackinnon had applied to the Government at first for a loan of 5 lakhs on the security of the estate. Subsequently however, they increased it to a loan of 7 lakhs. The application appeared to the U. P. Government to be deserving support inasmuch as the growth of such central factories was required to secure the flow of capital into similar enterprises. The loan was sanctioned by the Government of India and paid out of the provincial loan account. It bore an interest of 5% and was

[1] Evidence of the Hon'ble Mr. A. W. Pim, I.C.S., Financial Secretary to the Government of the United Provinces. Indian Industrial Commission, *Minutes of Evidence*, Vol. I, pp. 177-78.

repayable by equal yearly instalments spread over 20 years, beginning two years after the grant of the loan.[1] The concern had to pay Rs. 20,000 a year plus interest to the Government. It was a marked success and the Government was paid back their money.[2] A third loan of 5 lakhs was advanced to the Tamkahi Sugar Factory which had a capital of 10 lakhs on the security of landed property with no government control during the period of the loan.[3]

In pursuance of the resolutions of the Industrial Conference held at Nainital in August, 1907, referred to above, the Government of the United Provinces decided to carry on an experiment in the cotton seed oil industry at Cawnpore. It was arranged with Messrs. Begg Sutherland & Co., of Cawnpore, that the Government would meet the cost of the building and the plant laid down in the factory and would pay Rs. 500 to the company for supervision and control during the experimental working. The company was to find the funds for the purchase of the raw materials and general working expenses. It was also arranged that the Bank of Bengal would find the working capital and that the Government would make good every six months whatever overdraft there might be on the account. The factory, however, had to be closed down in February, 1911, in view of the orders of the Secretary of State in his Despatch No. 50, dated the 29th July, 1910, prohibiting State interference in the way of pioneering new industries. The total Government expenditure on the experiment amounted to Rs. 1,74,611 and the total loss to the Government was Rs. 38,219. The Government pioneer venture was bought by Messrs. Hope Bros., of Cawnpore. The State experiment in their hands was rapidly transformed into a sound business concern. In 1914, the Government of India was

1 Evidence of the Hon'ble Mr. A. W. Pim, I.C.S., Indian Industrial Commission. *Evidences*, Vol. I, p. 179.

2 Evidence of Mr. W. Maxwell—Kamrup Government Farm. *Ibid.*, *Minutes of Evidence* (Confidential), Vol. VI, p. 90.

3 Evidence of the Hon. Mr. H. R. C. Hailey, Director of Land Records and Agriculture, U. P., *Ibid.*, Vol. VI, p. 91.

approached by the Provincial Government for obtaining sanction to the grant of a loan of Rs. 37,500 to the firm for additional capital required by it out of the advance and loan account. The interest would be 5% and the security would be a separate first mortgage on the machinery to be purchased with the loan and two approved names plus a further mortgage on the existing buildings, machinery and plant, which were valued at Rs. 88,888 in the firm's balance-sheet. The loan was sanctioned by the Imperial Government *on condition that it would be fully repaid* with principal and interest within 10 years from date. The mere promise of Government support in this case had the remarkable effect of attracting private capital to this enterprise and a group of capitalists undertook to provide further finance up to 6 lakhs of rupees if necessary. The concern was the Premier Oil Mills Company, Ltd.[1]

In December, 1915, the Government of the United Provinces obtained sanction from the Government of India for a loan of Rs. 2,000 to the Ferozabad Bangle Makers' Society provided Rs. 3,000 was raised from a District or Central Co-operative Bank. The Local Government also approached the Central Government for permission to grant a loan of Rs. 20,000 on easy terms to Mr. Ishwar Das Varshnei to assist him in establishing a glass working factory at Bijhoi in the Moradabad District.[2]

Applications were made from time to time by several industries to the Director of Industries for financial assistance. One Mr. Rustomjee of Cawnpore applied for a grant or subsidy of Rs. 5,000 to start a factory for making paints and varnishes. The application was subsequently withdrawn. An application for a loan of Rs. 7,500 was made by the Director of Gorakhpur Training Factory, Ltd., which was devoting special attention to the production of "patent" leather. At their meeting of 14th

[1] Evidence of Mr. A. W. Pim, I.C.S., Indian Industrial Commission, Vol. I, pp. 172-73.
[2] *Ibid.*, Vol. I, p. 181.

September, 1915, the Board of Industries recommended to the Government that a loan of Rs. 5,000 might be granted to the company inasmuch as they were undertaking pioneer work. The perfume manufacturers of Kanauj, desirous of forming a limited liability company, applied to the Government for a guarantee of the interest on capital for the first five years. A sum of Rs. 5,000 was actually reserved in 1915 for assistance to minor industries such as pencil making, button manufacturing, etc., and the Director of Industries was asked to work out suitable schemes for the allotment of the money.

The Madras State-Aid to Industries Act, 1922:

The Madras Government was the first provincial government to act up to the recommendations of the Indian Industrial Commission for rendering State assistance to the indigenous industries of the province. Within a few years of the publication of the report, the Government of Madras brought forward in the Legislative Council a Bill to give State assistance to the industries of the Presidency according to the recommendations laid down there. The Bill followed to some extent the lines of certain rules of the Mysore State "for the grant of loans to facilitate agricultural and industrial operations and for the purchase and erection of machinery."[1] The Industrial Commission had studied the Mysore Legislation and must have had it in their mind when they recommended financial assistance to industries by the State. These rules authorised the Mysore State to grant loans of money (1) for the purchase and erection of machinery for agricultural and industrial undertakings, (2) for the construction of wells or tanks, of mills, warehouses and other structure necessary for agricultural and industrial operations, and (3) for the provision of raw material, working capital or other appliances required for the carrying on of industrial operations.

1 Mysore Government Order No. G. 2097-145 G. M. 55-12-239, dated 2nd September, 1918.

Loans not exceeding Rs. 1,000 might be granted by the Director of Industries and Commerce. Loans granted for (1) and (3) should ordinarily be subject to a limit of Rs. 10,000 and Rs. 5,000 respectively, the rate of interest being 6¼% per annum. The time allowed for repayment of the loans should not exceed 5 years when they were for industrial purposes and 7 years when for agricultural purposes. All loans should be recoverable as arrears of land revenue and no loan should be granted unless the value of the security was at least equal to the amount of the loan. The nature of the security should be saleable interest in lands or other immovable property held by the borrower plus the mortgage of the whole plant, machinery and buildings on the purchase and erection of which the loan was expended. Instead of offering security of immovable property for a loan to purchase machinery, the applicant might obtain the requisite machinery from the Director of Industries on the hire-purchase system, provided one fourth of the value of the machinery was deposited. A special officer of the Department of Industries should make a local enquiry and report to the Director before any loan could be granted. In some important respects, the Madras Bill was also closely analogous to the legislation enacted in post-war years in several Empire countries to provide for State-aid to industry and indeed might have been modelled on the same lines.

The Bill, entitled the Madras State-Aid to Industries Bill, was introduced on the 14th November, 1922, by the Hon'ble Minister Rai Bahadur K. V. Nayadu. The Bill was intended to assist the establishment and development of industries that "had an important bearing on the economic development of the province."[1] It was passed into law with some amendments by the Council on the 20th December, 1922, and came into operation from 22nd December, 1923. The Act provided that the industries which would receive aid under it were :[2]

(a) new or nascent industries;

1 Madras Legislative Council Proceedings, Third Session, 1922, Vol. 9, p. 618.

2 Clause 5, Sec. (1) of the Act.

(b) industries to be newly introduced into areas where such industries were undeveloped;

(c) cottage industries.

The Local Government under its provisions had the power to give aid to an industrial business or enterprise in one or more of the following ways :[1]—

(a) by granting a loan;

(b) by guaranteeing a cash credit, overdraft or fixed advance with a Bank;

(c) by paying a subsidy for the conduct of research or for the purchase of machinery;

(d) by subscribing for shares or debentures;

(e) by guaranteeing a minimum return on part of the capital of a joint-stock company;

(f) by making a grant on favourable terms of land, raw materials, fire-wood or water, the property of the Local Government.

It is noticeable that the Madras Act had no provision for making plant available for cottage industries on the hire-purchase system, which was provided for by the Mysore State Rules,[2] and was also one of the most important recommendations of the Industrial Commission. It is evident that the hire-purchase system is much preferable to the loan system in the case of individuals who may not be able to give sufficient security or guarantee to Government which is required for the granting of the loans. The plant under the hire-purchase remains the property of the Government and no fresh security is therefore necessary. It is distressing to find that the Government could not accept an amendment made by Rai Bahadur C. V. S. N. Raja inserting a provision to that effect.[3] State-aid in any of the above forms might be given to a joint-stock company provided it was registered in India with a rupee capital, a minimum number or proportion

1 Clause 6.

2 Rule 12.

3 Madras Legislative Council Proceedings, Vol. 10, pp. 1060-61.

of the members of the Board of Directors were Indians and it made arrangements for the training of apprentices as prescribed by the Government.[1] As regards the amount of the loan, it was originally enacted that it should not exceed 50% of the net value or assets of the industrial business or enterprise after deducting existing encumbrances.[2] Every loan granted under this Act was to be secured by a mortgage or floating charge upon the whole of the assets of the business or enterprise.[3] Where the amount of the loan granted was two lakhs or over, the Local Government were to ensure such control as would be sufficient to safeguard their interests by appointment of Government directors or otherwise.[4] The duration of the loan which was repayable by instalments should not exceed a period of 20 years unless the Local Government extended the same.[5] Where a loan had been applied for or where it was granted, the applicant or the grantee, as the case might be, should be bound (*a*) to comply with any general or special order of the Local Government relative to the inspection of the premises, buildings, or plant or stock in hand of the industrial business or enterprise, (*b*) to permit the inspection of all accounts relative to it, (*c*) to furnish full returns of all products manufactured, or sold both as regards description and quantity, (*d*) to maintain such special accounts or to furnish such statements as the Local Government might from time to time require, and (*e*) to submit the accounts to such audit as the Local Government might prescribe.[6]

The other forms of State-aid under the provisions of the Act, *viz.*, guarantee of cash credits, overdrafts or fixed advances with a bank were to be given in the same manner as the grant of a loan. As for Government subscription of shares and debentures or

[1] Clause 5, Section (2).
[2] Clause 9.
[3] Clause 10.
[4] Clause 12.
[5] Clause 13 Secs. (1) and (2).
[6] Clause 11.

guarantee of a minimum return of an industrial business, it was enacted that for all shares subscribed by the Government, there must be taken up and fully paid for not less than an equal number of shares and that for all capital on which a return was guaranteed, there should be paid up not less than an equal amount of capital which carried no guarantee.[1]

In the case of an application for a loan exceeding Rs. 50,000, or any other case when considered necessary, a notice should be published in the prescribed manner calling upon any person who objected to the grant of the aid applied for to state his objections so that such objections might be heard and necessary enquiries be made.[2] Applications for State assistance were to be placed before a Board of Industries on whose recommendation the Local Government would sanction the loans. The Board was to consist of not less than 10 and not more than 12 members of whom not more than 3 should be Government officials. The Madras Chamber of Commerce, the South India Chamber of Commerce, the Madras Trade Association were empowered to elect one member each and the Madras Legislative Council two members to the Board. The Director of Industries and the Secretary to the Government of Madras, Finance Department, were to be *ex-officio* members of the Board.[3] The functions of the Board were to be purely advisory, though their advice would necessarily carry great weight. The industrial business which received State-aid should not pay any dividend or distribute or take any profits in excess of such a percentage rate on the amount of its capital as might be fixed by the Government from time to time. The balance of the profits after setting aside proper amounts for depreciation and for the payment of interest on debentures should be carried to a reserve fund to be utilised in the manner Government might approve. This section was drawn up keeping in view the provisions of the rules passed at that time by the Board of Trade in England

[1] Clause 15.

[2] Clause 8.

[3] Clause 3.

in order to guide the grants made by the Government to the British Dyes, Ltd.[1]

As regards the recovery of the money due to the Government under this Act, it was laid down that all arrears of moneys including any interest and costs might be recovered from the person aided and his surety as if they were arrears of land revenue.[2] The interest charged on the loans granted under the Act must be at least one half per cent. more than the rate at which the Madras Government last borrowed for the provincial loan account. It has actually varied between $6\frac{1}{2}\%$ and $7\frac{1}{2}\%$. The securities on which loans are advanced are carefully tested and the full value of the loans advanced is intended to be secured. The valuation is conducted by the Industries Department which is sometimes assisted by the Revenue Department.[3]

The first meeting of the Statutory Board of Industries considered seven applications for State-aid. Only two out of these seven applications were recommended by the Board, *viz.*, one from Messrs. Muppama Somaraju and Veerarju, Silk Cloth Manufacturers, for a loan of Rs. 50,000 to develop their factory, and another from Messrs. Kelkar Bros., Managing Agents of Canara Rice and Saw Mills, Ltd. (Coondapur), for a loan of Rs. 10,000 to purchase certain machineries. In the first case the entire amount was sanctioned by the Government and in the second case, only Rs. 9,000 was sanctioned according to the Board's recommendation as the net assets of the company were not adequate for a larger loan. The loans were disbursed on the 23rd December, 1924 and 31st March, 1925, respectively.[4]

In the next year the Board considered nine applications. Among these, there was an application from the Carnatic Paper Mills, Ltd., for a loan of 4 lakhs and also for a guarantee of overdraft or fixed advance with a bank of 2 lakhs of rupees. The

1 Madras Legislative Council Proceedings, 1922, Vol. 9, p. 653.

2 Clause 18.

3 Proceedings of the Fifth Industries Conference, 1933, p. 11, p. 24.

4 Report of the Department of Industries, Madras, 1925, p. 7. Also Report for the year, 1926, p. 6.

loan was recommended and the Government sanctioned and disbursed it on the 14th March, 1925. As regards the guarantee of the overdraft the company failed to convince the Government that if it was guaranteed, the company would be able to finance the development of the concern. The Government further sanctioned a loan of Rs. 5,000 for establishing a small cotton ginnery in North Arcot District and a loan of Rs. 18,600 to the Kalla Kurichi Society which applied for Rs. 25,000 under section 6(*a*) of the Act to develop rice hulling and sugarcane crushing.[1] During the year ended 31st March, 1926, the Board recommended to the Government two applications from the Carnatic Paper Mills for further loans of Rs. 50,000 and Rs. 3,50,000. The Government sanctioned Rs. 30,000 in the first instance during the year and Rs. 20,000 afterwards in the beginning of the next financial year. The Government had allotted Rs. 4 lakhs in the Budget for 1925-26 under the heading "advances under special loans, the State-Aid to Industries Act." Only 3 loans amounting to Rs. 53,600 were disbursed during the year and the balance was resumed by Government towards the close of the year. From the date on which the Act came into force up to the year ended 31st March, 1926, six loans totalling Rs. 5,13,200 were sanctioned and disbursed. The Carnatic Paper Mills alone were granted Rs. 4,30,000 out of this amount. The Carnatic Paper Mills received a further loan of Rs. 9,000 on the 29th March, 1927. In August, 1926, the Government had also guaranteed an overdraft for the company with the Imperial Bank amounting to Rs. 1,34,469-3-4.[2]

An amount of 4 lakhs was again provided in the Budget for the year 1926-27 for the purpose of loans under the State-Aid to Industries Act but only two loans totalling Rs. 29,000 were disbursed during that period.

1 Report of the Department of Industries, Madras, 1926, pp 6-7.
2 Report of the Department of Industries, Madras, 1927, p. 4.

In the year ending 31st March, 1928, two loans were sanctioned by the Government one for Rs. 10,000 to Salem Dye Works which was recommended in the previous year, and the other for Rs. 11,000 to zaminders of Belgaum for developing their pyrotechnic match factory. They were disbursed on 26th November, 1928 and 18th July, 1928, respectively.[1]

During the year 1929, out of a total amount of Rs. 4 lakhs sanctioned in the Budget, Rs. 1,71,842-5-4 only was disbursed Rs. 21,000 being the amount loaned out to new concerns.[2]

In the following year the Board considered 8 applications. Of these the most important was from K. S. Sankaram Pillai for a loan of Rs. 10,000 to establish a tobacco re-drying factory. It was recommended by the Board and also sanctioned by the Government. But the applicant subsequently informed the Government that he was not prepared to avail himself of it. Another application for a loan of Rs. 7,500 from Tanjore Tile Works was adjourned for further consideration. It was later on recommended that Rs. 4,250 might be advanced to the concern and this was sanctioned by the Government.[3]

During 1931, 17 applications were considered of which 10 were rejected. A loan of Rs. 750 was granted to Mr. L. Nânjudaswami to work up his silk reeling concern. Loans were also sanctioned to two toy manufacturers to develop the toy industry.[4]

Up to 31st March, 1933, the Board of Industries considered 77 applications for loans of which those from 14 concerns were granted. The loans actually disbursed were 15 in number involving an aggregate amount of Rs. 8,27,415-8-0.[5] Of this, Rs. 6,49,215-8-0 was advanced to the Carnatic Paper Mills, Ltd., alone. The balance was distributed among other businesses, the largest amount loaned to such enterprises being Rs. 50,000 to

1 Report of the Department of Industries, Madras, 1929, p. 3.

2 Report of the Department of Industries, Madras, 1929, p. 5, p. 102.

3 Reports of the Department of Industries, Madras, 1930 and 1931, p. 3 and p. 4.

4 Report of the Department of Industries, Madras, 1931, pp. 3-5.

5 Proceedings of the Fifth Industries Conference, July, 1933, p. 11.

Messrs. Muppama Somraju and Veerju to develop a silk factory and the smallest being Rs. 500 to the proprietors of Ram Ram Safety Match Factory.[1] We give below a statement showing the nature of industry assisted and the amount of financial assistance granted in each case[2] :—

		Rs.	As.	P.
1.	Paper Mills	6,49,215	8	0
2.	Silk Factory	50,000	0	0
3.	Match Factory	20,000	0	0
4.	Oil Mill	40,000	0	0
5.	An Industrial Co-operative Society carrying on rice milling, groundnut decorticating, etc.	18,600	0	0
6.	Pyrotechnic Match Factory	11,000	0	0
7.	Dye Works	10,000	0	0
8.	Metal Industry	8,000	0	0
9.	Saw Mills	9,600	0	0
10.	Cotton Ginnery	5,000	0	0
11.	Tile Factory	4,250	0	0
12.	Silk Reeling Concern	750	0	0
13.	Toy Manufacturer	500	0	0
14.	Another Match Factory	500	0	0

From an examination of the affairs of the industrial concerns which received State-aid under the terms of the Madras Act, it cannot be claimed that the results have fulfilled expectations. The Act has been in force for nearly two decades but there is hardly any indication that it has stimulated the economic development of the province to any appreciable extent.[3] Most of the

[1] Report of the Madras Provincial Banking Enquiry Committee 1931, pp. 131-32.

[2] Proceedings of the Fifth Industries Conference, 1933, p. 13.

[3] State Action in respect of Industries, 1928-35, p. 39. (Published by the Government of India.)

companies to which financial assistance was given have not been able to repay the instalments of the loans as required under the provisions of the Act. They failed to show any profits and most of them have closed down. The Carnatic Paper Mills, Ltd., which obtained the bulk of the advances under the Act was a failure. They were unable to clear the overdraft which the Government had guaranteed with the Imperial Bank on the due date and the Government had to treat the whole amount as loans. They could not meet their liabilities to the Government and had to be taken over on the 10th December, 1928. Orders were passed by the High Court for the compulsory winding up of the company. An official liquidator was appointed and the concern was sold to a new company floated under the name of Andhra Paper Mills. The Government received Rs. 4 lakhs from them and had to write off Rs. 3,86,428 of the loan and interest outstanding. The affairs of the Kanara Rice and Saw Mills, Ltd., were also not satisfactory. During 1925-26 the firm incurred a net loss of Rs. 3,659-11-8. It failed to pay the 2nd, 3rd and 4th instalments of the loan granted by the Government. It was closed down in 1928 and the Collector was asked to collect the entire sum due. Before the confirmation of the sale the managing agents paid almost the entire outstanding liabilities to the Government and the balance has since been collected. The Andal Mills at Gudiyattam sustained a loss of about Rs. 3,000 during the year ending 31st March, 1928. Failing to pay the second instalment of their debts, the proprietors prayed for a postponement by one year of the repayment of the instalment but the prayer was not granted. The Collector was asked to take steps to collect the dues. Rs. 800 was realised out of the sale of the concern and out of the balance still due to the Government Rs. 1,713 had to be written off.[1] The Bellary Match Factory of Mr. M. S. Ramanna which

[1] Report of the Department of Industries, Madras, 1931, p. 5. Also Report, 1937, p. 33.

was granted a loan of Rs. 20,000 was not a success. It did not work much during the year 1928-29. In the next year a fire broke out and damaged the machinery. A dispute arose between the proprietor of the concern and the Insurance Company as to the amount of the damage. The Government decided to sell the concern to realise the loan granted to it. The machinery, when sold, fetched only Rs. 4,500. The Salem Dye Works stopped working shortly afterwards it received the loan on the plea of hardness of water and did not resume work. In the case of the Parvatipur Industries, Parvatipuram, there was a net loss of Rs. 1,391-1-4 during the year 1930-31. The only concern which may be said to be truly successful is the Srilakshmi Silk Factory of Messrs. Muppama Somaraju and Veerju, Peddupuram. It always repaid the instalments by the due date and by 1931 repaid almost the entire outstandings. The Pyrotechnic Match Factory appeared to have been working satisfactorily at the outset and during the year ending 31st December, 1928, it earned Rs. 2,733-11-5 as net profit. But in more recent years it has failed to show any profits.[1] The Ramkrishna Sugar Mills, which was recently assisted, also sustained a loss of Rs. 33,940.[2] It is abundantly clear that the position of the majority of the concerns assisted under this Act was far from satisfactory. The cottage and small industrialists found it extremely difficult to avail themselves of the facilities of State-aid under the Act. They could not ordinarily show assets double the amount of the loan applied for nor could they be expected to show detailed accounts on the lines required by Section II of the Act and Rules 16 and 17 of the Rules framed under the Act. A cottage worker applying for a small loan cannot reasonably be expected to incur the expense of employing a clerk or accountant to maintain the registers and accounts required

1 Proceedings of the Fifth Industries Conference, 1933, pp. 13-15.

2 Report of the Department of Industries, Madras, 1937, p. 84.

or to incur the expense involved in the audit of such accounts by certified auditors. The Director of Industries in his Report of 1927, pointed out the desirability of exempting such concerns from the operation of the Act. During the year 1930-31 the question of simplifying the formalities connected with the rules was examined with a view to make it possible for the Act to become more readily available to the cottage industries. The Government amended Rule 21 (*d*) of the Rules framed under the Act whereby an enterprise with assets not exceeding Rs. 500 was exempted from insuring the properties mortgaged to Government against loss or damage by fire. A small concern whose capital outlay did not exceed Rs. 1,000 was also exempted from payment of a stamp duty on mortgage deeds securing repayment of a loan under the Act. A scheme for the supply of textile appliances was also sanctioned in 1932 but the results were disappointing.[1]

The Public Accounts Committee in 1936, expressing the view that the Act had failed to achieve the objects for which it was introduced, recommended its amendment so that the Government's policy in the sphere of industrial finance might be rendered more effective. The Act was accordingly amended in December, 1936. Clause 2 (1) of the Amended Act provides for the grant of aid to old and established industries in addition to new and nascent industries. Sec. 9 of the original Act was also amended. The limit of the loan which may be granted has been fixed in all cases at .50% of the value of the assets of the business plus the value of the other property if any, offered as collateral. Cottage industries have been re-defined as those "carried on by workers in their own homes as distinct from those carried on in factories." The Government will now be able to assist cottage industries even though the middlemen may stand to benefit.[2]

[1] *State Action in Respect of Industries*, 1928-35, *op. cit.*, p. 39.
[2] Report of the Department of Industries, Madras, 1937, p. 6.

The Bihar and Orissa State-Aid to Industries Act, 1923

The Bihar and Orissa State-Aid to Industries Bill patterned after the Madras Act was introduced in the Legislative Council by the Hon'ble K. B. S. M. Fakhruddin on the 13th July, 1923, and was passed in the same year. The object was to regulate the giving of the most common forms of State-aid to industries in order that the principles on which such loans should be given might be well defined.[1] The provisions regulating the grant of long-term finance to suitable industrial enterprises like those of the Madras Act include direct advances at low rates of interest, lower than any charged by a bank or any other financier, subscription to shares or debentures, guaranteeing of cash credits with banks and of a minimum return on the whole or part of a joint-stock company's capital. As regards the subscription for shares or debentures, it is provided that for all shares and debentures taken by the Government, at least an equal amount must be subscribed for by the public (Section 16.) In addition to all these, the Act provides for the supply of machinery on hire-purchase basis, a feature which, we noticed, was absent in the case of the Madras Act.[2] No machinery should be supplied on the hire-purchase system unless the applicant deposits with the Director of Industries at least 20% of the cost of the machinery. The Government should be protected against the total or partial loss of such machinery from risk or any other cause by means of an insurance, a mortgage on immovable property, the personal guarantee of one or more persons or in any other manner.[3] Whenever the application for State-aid in any of the above forms exceeds Rs. 10,000, the Director of Industries has to advertise it in the Local Official Gazette in its three successive issues with a view to invite any possible objection.[4] He also cannot sanction it without the

1 Bihar and Orissa Legislative Council Proceedings, 1923, Vol. 8, pp. 33-39.

2 The Bihar and Orissa State-Aid to Industries Act, 1923, Sec. 4.

3 The Bihar and Orissa State-Aid to Industry, 1923, Rules 13 and 14.

4 *Ibid.*, Rule 4. See also Sec. 7 (3) of the Act.

concurrence of a majority of the members of the Board of Industries. Money is advanced on the security of land, plant and machinery of an industrial concern at an interest rate of 6½% and the maximum period over which repayment of loans can be spread is 20 years.[1] Every loan granted to an industry should be secured by a mortgage or floating charge upon the whole of the assets of such industry subject to any encumbrances existing at the time when the loan is granted and by such collateral security as the Government may require (Section 10). No loan or guarantee of a cash credit will be given exceeding in amount seventy per cent. of the net value of the assets of an industry after deducting the value of all prior encumbrances. Whenever the amount or value of the State-aid is two lakhs of rupees or more, the Government should obtain control over the conduct of industry by appointing directors or otherwise.[2] It is evident from Sections (4) and (5) of the Act that the terms are broad enough to include all kinds of industries. But it can not lend to old established industries unless they are being started in a new area. The Act does not forbid the grant of short-term loans but such loans are not granted.

Applications for State-aid must be made to the Director of Industries in prescribed forms. Fullest information is required to be given as regards the security for any loan or advance. Details as to the financial resources of the applicant, the assets and revenues which will be available as security for it and particulars of any existing charges on it as well as any debts owned by the applicant should be furnished. Balance-sheets and profit and loss accounts when such exist certified by an auditor entitled to audit accounts of companies under the Indian Companies Act, 1913, should be attached. In the event of the applicant being a company, a copy of the prospectus and memorandum and articles of association should also be attached.

1 The question of reducing the rate of interest from 6½% to 3% has recently engaged the attention of the Board of Industries. (See Annual Report, 1936-37, p 33.)

2 Section 19 of the Act.

Information should also be given as to the collateral security offered. The application should be sent with a covering letter, explaining the prospects and facilities available for the development of the industry, the nature of the process to be utilised, the staff to be employed and the history of the industry from its inception up to the date of application.[1]

During the first year of the operation of the Act, the Statutory Board of Industries received for consideration 11 applications for State-assistance. Of these the most important was an application from the Indian Steel Wire Products, Ltd., requesting the Government to take up debentures in the company. The Board recommended the application and the Government decided to take up debentures to the extent of of rupees 5 lakhs; the conditions being that the company should write down its assets and share capital by 50%. The application of the Puri Match Industries Company, Ltd., for the supply of match machineries on the hire-purchase system was also granted, and the supply of machinery up to the value of Rs. 5,000 was approved of by the Board and sanctioned by the Director of Industries. There were two applications for Government guarantee of cash credits. One from the Vishwakarma Mills, Ltd., Dighaghat, for Rs. 75,000 and the other from the proprietors of a rice hulling plant. The Government arranged a cash credit in favour of the Vishwakarma Mills, Ltd., with the Imperial Bank under its guarantee. The latter was also sanctioned but not drawn upon. The total amount actually paid out in loans and under the hire-purchase system before the close of the year 1924-25 was Rs. 5,03,534, and of this, the Indian Steel Wire Products obtained Rs. 5 lakhs.[2]

During the next year (1925-26), the second year of the operation of the Act, 13 applications were considered by the Board. The Government granted an application from the

[1] The Bihar and Orissa State-Aid to Industry Rules, 1923. Bulletin form No. 12. Department of Industries, Bihar and Orissa, pp. 6-7 (Forms V and B).

[2] Annual Report of the Department of Industries, Bihar and Orissa, 1924-25, pp. 33-35.

proprietor of a canning business for a loan of Rs. 40,000 to develop his fruit canning factory at Muzaffarpur and also another from Rai Sahib B. Lal for the supply of button-making machinery worth Rs. 9,500 on the hire-purchase system.[1]

There were some important applications for cash credits during the year. Messrs. Baldeo Das Narayan Das wanted a guarantee of cash credit of Rs. 2 lakhs for installing an adequate steampower plant in the Shibagauri Flour Mill at Bhagalpur. The Government arranged for it with the Imperial Bank but difficulties arose in connection with the working of the cash credit with the Bank. The latter refused to supervise the debtor's operations on the credit so long as the stocks were not hypothecated to it. The fixed assets were already mortgaged to the Government for the purposes of the guarantee and the hypothecation of its current assets in addition to the Bank would have crippled its power of raising any further finance. Hence the sanctioned credit was not actually availed of. The same difficulty arose in the case of a cash credit of 1 lakh of rupees applied for by Messrs. Jaipaldas Jitaldas and the cash credit was not availed of by them.[2] The third application was the one from Messrs. L. D. Brothers who wanted a credit of Rs. 50,000 on the security of landed property. It was referred to the Allahabad Bank to see if it were possible to arrange a cash credit with a bank without Government guarantee on the securities offered.

During the year 1927-28, there were 16 applications for consideration before the Board. The following were sanctioned by the Government :—

(1) A loan of Rs. 5,000 to a factory manufacturing hand hammer shafts.

(2) A loan of Rs. 5,000 to a factory grinding optical lenses.

[1] Annual Report of the Department of Industries, Bihar and Orissa, 1925-26, p. 36.

[2] See Government Resolution on the Annual Report of the Department of Industries, Bihar and Orissa, 1925-26, pp. 4-5.

(3) Rs. 32,000 worth of rice mill machinery on the hire-purchase system of which machinery worth Rs. 7,000 was wanted at first.

(4) Rs. 5,000 worth of wood working machinery.

The Board considered 16 applications during 1928-29. An oil expeller costing up to Rs. 7,000 for M. Ahmad of Tebta and a *dal* mill worth Rs. 9,500 for Babu Madhusudan Pal [1] were sanctioned by the Government. A cash credit was arranged with the Imperial Bank Branch at Gaya for Rs. 5,000 in favour of the owner of a rice-milling business. In the course of the next year (1929-30) the total amount advanced was Rs. 24,649, the principal industries aided being the *dal* and the hosiery.

During 1930-31, ten applications were considered by the Board, four of which were from the previous year. Six of them were rejected. Most of the rejected applications were from the existing businesses for cash credit to tide over the difficult times. The total value applied for including cash credit, loan and hire-purchase was Rs. 95,000 of which only Rs. 10,000 was allowed, distributed as follows :[2]—

(1) A loan of Rs. 1,500 for an ink manufacturing business.
(2) Wood-working machinery worth Rs. 4,500.
(3) An oil engine worth Rs. 2,000.
(4) An *Atta* mill worth Rs. 2,000.

The year 1931-32 was a year of unprecedented depression in trade and industry and for the first time since the passage of the State-Aid to Industries Act in Bihar and Orissa no provision could be made in the Budget for State-aid.[3] In the next year (1932-33) also, no such provision could be made in the

1 He did not avail himself of it.

2 Report of the Department of Industries, Bihar and Orissa, 1930-31, p. 5.

3 Government Resolution on the Annual Report of the Director of Industries, Bihar and Orissa, 1931-32.

Budget.[1] After a lapse of five years provision could be made in the Budget of 1936-37 for advancing loans to small industrialists not exceeding Rs. 500 in any one case.[2] The Act had become virtually inoperative during this period.

In his evidence before the Bihar and Orissa Banking Enquiry Committee, the Director of Industries stated that altogether 98 applications for state-aid from 33 different industries were received by the Government. The gross value of these applications amounted to nearly Rs. 39 lakhs. Of these, 19 applications were for loans, the value of which was Rs. 5,84,750. Only two were sanctioned, the value thereof being Rs. 45,000. Applications for the taking of debentures by the Government were two in number, of which one was sanctioned, the value being Rs. 5,00,000. There were 21 applications for cash credit of which 7 were sanctioned involving Rs. 4,13,000, the amount actually guaranteed being Rs. 80,000. The number of applications for machinery on the hire-purchase system was the largest, *viz.*, 55. Only 27 were granted and the amount actually paid by the Government was Rs. 1,88,859. Thus out of 98 applications, 37 were sanctioned, the total value thereof being over Rs. 13 lakhs.[3] The total amount actually given out as State-aid since the passing of the Act up to 1933, amounted to Rs. 7,91,000 of which Rs. 3,79,000 was realised while Rs. 3,80,000 was definitely ascertained as bad debts and Rs. 97,000 was still outstanding.[4]

The history of the working of the State-Aid to Industries Act in Bihar and Orissa is almost as unhappy as in Madras. The perusal of the report of the Director of Industries, 1930-31, makes melancholy reading. It discloses the lamentable fact that no enterprise aided between 1924-28 excepting one was surviving in the hands of the original owners. Most of the aided industries

1 Government Resolution on the Annual Report of the Director of Industries, Bihar and Orissa, 1932-33.

2 Annual Report of the Director of Industries, Bihar. for 1936-37, p. 23.

3 Bihar and Orissa Provincial Banking Enquiry Committee, Vol. II (Evidences), p. 212.

4 Government Resolution on the Annual Report of the Director of Industries, Bihar and Orissa, for 1932-33. Also Proceedings of the Fifth Industries Conference, 1933, p. 19.

could not make any profit and were unable to pay their debts to the Government according to the terms of the Act. Of the nearly 8 lakhs of rupees advanced, as already noted, only 3 lakhs were repaid and an equal sum had to be written off as irrecoverable. The Government of Bihar and Orissa heavily financed the Indian Steel Wire Products, Ltd., just as the Madras Government had done in the case of the Carnatic Paper Mills. Five lakhs out of the eight advanced under the Act went to this single company. As early as 1927 the company declared its inability to carry on its business. The trustees took over its property in accordance with the terms of the debenture deed and the concern was sold to Mr. Indra Singh of Jamshedpur. The Government received only Rs. 2,30,672 against the five lakhs advanced, the loss amounting to Rs. 2,69,328.[1] The Puri Match Factory paid the first instalment but could not pay the one due on February, 1929. Its connection with the Government ceased in 1930-31, the net loss being Rs. 1,574-3-4. The Vishwakarma Mills stopped working and went into liquidation. The fruit-canning factory at Muzaffarpur was unable to pay its instalments and the aid was withdrawn. The Rice Mill at Tehta also defaulted. The loss over the transaction amounted to Rs. 9,564 which was written off.[2] The concerns manufacturing buttons and hammer handles also defaulted in repayments.[3] A sum of Rs. 30,000 was practically lost on a combined enterprise for rice-milling and oil foundry work, as the security on which the loan was granted proved unsaleable except at ruinous sacrifice. The scheme of advancing under the hire-purchase of machinery system has also proved disappointing and the Industries Department has become a "museum of obsolete machineries."[4]

The Bengal State-Aid to Industries Act, 1931 :—

In Bengal there was no legal provision for State-aid to industries till 1931. The State-Aid to Industries Act was passed

[1] Annual Report of the Director of Industries, Bihar and Orissa 1928-29, p. 34.

[2] *Ibid.*, 1936-37, p. 83.

[3] *Ibid.*, 1930-31, p. 3.

[4] Report of the Bihar and Orissa Provincial Banking Enquiry Committee.

in Bengal on the 23rd July, 1931. A Board of Industries has been created under its provisions and it is intended that the Board should be "an expert, workable and efficient body limited to a small number of gentlemen interested in the province and capable of taking responsible action."[1] The Board is to consist of the Director of Industries, two members of the Legislative Council, one member each elected by the Bengal Chamber of Commerce, the Bengal National Chamber of Commerce, the Calcutta Trades Association and the Marwari Association, one member, an employee of the Imperial Bank and appointed by the Government and two members, not Government servants, appointed by the Local Government.[2] The duty of the Board is to receive applications for State-aid and to report upon them to the Local Government and "to frame complete schemes and programmes for such State action as the Board considers necessary for the steady and progressive development of industries for the consideration of the Local Government."[3]

As regards the industries to be aided, they are the same as in Madras, but the forms of State-aid are much more varied and extensive in Bengal than either in Bihar or Madras. The Bengal Act contains provisions not only for the grant of secured loans, guarantee of cash credits, overdrafts and fixed advances, the taking of shares and debentures and guarantee of a minimum return on the whole or part of the capital of a joint-stock company but also provisions for guarantee of interest on preference shares and debentures and for the supply of machinery on the hire-purchase system.[4]

In Bengal, loans may be granted up to 50% of the net value of the assets of the industrial enterprise and the duration of the loan is not for more than ten years and may be for 20 years when the whole of it is secured on land or buildings or both.[5] As

1 Proceedings of the Bengal Legislative Council, July, 1931, Vol. XXXVII, p. 142.

2 Section 3 (1). The Bengal State-Aid to Industries Act, 1931.

3 Section 16.

4 Section 19 (1).

5 Section 19 (1) (a).

regards the disposal of profits during continuance of State-aid, Section 23 of the Act lays down that profits shall be distributed only after interest due on debentures and loans has been paid and an amount reasonable in the opinion of the Local Government has been set aside for obsolescence or depreciation of plant and machinery and a further amount which shall not be less than 25% of the net surplus available after provision for depreciation or obsolescence has been carried to a reserve fund to be utilised in the prescribed manner and payment made to a sinking fund for the purpose of repayment in the prescribed manner of any loan granted."[1] The Government during the continuance of State-aid will fix from time to time a certain percentage rate. All loans as in Madras and Bihar are recoverable as a public demand.[2]

It appears, at first sight, to be satisfactory to note that the Bengal Act does not contain the provision included in the Madras and Bihar Acts that applications for loans exceeding a certain amount would have to be advertised in the provincial Gazette. But though there is no provision for advertisement in the Act itself, the rules framed under the Act have provided that every application for aid, whether to be accepted or refused, must be advertised in the Calcutta Gazette and the daily newspapers.[3] In the case of a recent advertisement, it is seen that the amount of the loan applied for is only Rs. 500 for establishing an umbrella factory. When the application for such a small amount has to be advertised, it must be worse than the conditions under the Bihar Act. It is understood that the Bengal Act will be utilised chiefly to foster the development of small and cottage industries and is also expected indirectly to assist in the solution of the problem of middle class unemployment.[4] The main objective is to train educated young men in new and improved

[1] Section 23 (1).

[2] Section 25.

[3] Proceedings of the Bengal Legislative Council (Official Report), Vol. XLV, No. 2, p. 680.

[4] Administration Report of the Department of Industries, Bengal, 1932-33.

processes in such industries. Batches of young men from the educated middle classes will be given training in the mofussil in certain selected industries by demonstration parties; and machinery will be supplied on the hire-purchase system. The appointment of industrial surveyors to collect information regarding the marketing conditions and the possibilities of a ready market for the products of the industries in which training will be given, is an interesting idea under the scheme and is sure to prove valuable. The necessary finances are to be obtained from two sources, voluntary contributions from the public, which is absolutely a novel feature in Bengal and the provisions made by Government in the annual budgets. A local fund under the name of the Bengal State-Aid to Industries Act Fund has already been created out of the contributions made by some public-spirited men of the province, the assets of which stand at present at Rs. 54,000. The Government, however, were until 1934, unable to make adequate provision for financial assistance under the Act owing to financial stringency. In that year they took steps to provide in the Budget a fund of one lakh of rupees for the grant of State-aid in the shape of loans to industries under the terms of the Act. They also proposed to undertake the liability involved in the guarantee of a cash credit with a bank in accordance with certain provisions of the Act up to Rs. 50,000. The idea was to enable bonafide industrialists or small industrial concerns to tide over temporary financial difficulties by guaranteeing their overdraft from a recognised bank.[1] In the Budget for 1935-36, a reduced provision of Rs. 64,000 was made.

Although there was no legislation for State assistance in Bengal before 1931, the Department of Industries had actually come to the help of certain industries. In 1925 the managing agents of the Mohini Mills approached the Imperial Bank through the Director of Industries for assistance in opening a cash credit account with the Bank with the sanction of an overdraft up to Rs. 5

lakhs. The Director gave his support but the Bank did not see its way to extend its assistance. The Braziers' Co-operative Society at Brahmanbaria applied to the Department of Industries through the Registrar of Co-operative Societies for a loan of Rs. 8,000. As there were no funds for such industrial loans in the department, the matter was referred to Government and a loan of Rs. 7,000 was ultimately sanctioned.[1] The Calcutta Soap Works and the Calcutta Pottery Works each received a loan of Rs. 2 lakhs nearly from the Imperial Bank on the recommendation of the Director of Industries.[2]

The working of the Bengal State-Aid to Industries Act is also far from inspiring any faith in such legislations. When the Act was passed in 1931,[3] it brought great hopes to many a budding industrialist in Bengal, but after all these years of working, the Act does not appear to have benefited anybody. Up to March 6, 1935, the actual amount sanctioned by Government against 5 different applications was Rs. 11,000, of which Rs. 900 representing two small loans was refused by the applicants. The most important thing to be noticed in this connection is that in two years and a half there was no actual disbursement of money. Surprisingly enough the only money that had been spent so far on the working of the Act was Rs. 1,226 to pay for advertisements in the daily papers to invite objections to the applications recommended by the Board to the Government for sanction.[4] The working of the Act naturally, came under a fire of criticism in the provincial legislature from time to time. It was pointed out that though the Act was passed in July, 1931, it did not come to function till 1933. In 1933-34

1 Annual Administration Report of the Department of Industries, Bengal, 1925, pp. 15-17.

2 Evidence of Mr. Weston, Director of Industries, Bengal—Bengal Provincial Banking Enquiry Committee, Vol. II, p. 180.

3 Although the Act was passed in July, 1931, rules framed under the Act as sanctioned by the Government were not published till July, 1933.

4 Proceedings of the Bengal Legislative Council (Official Report), 45th Session, Vol. XLV, No. 2, pp. 678-79.

no money was provided in the Budget for granting financial assistance under the Act. In 1934-35 a lakh of rupees was provided for but not a rupee was spent out of it and according to the rules the entire sum reverted back to Government. In 1935-36 the provision was reduced. Only Rs. 16,100 were disbursed as loans during the year. In the next year the disbursement amounted to Rs. 40,075 and recovery on account of loans advanced was Rs. 3,145 as against Rs. 52l in the preceding year. All the loans were paid out of the Board's own funds and the Government money provided in the Loan Budget was not touched.[1]

STATE-AID TO INDUSTRY IN OTHER PROVINCES

Central Provinces :

A State-Aid to Industries Act on the lines of the Madras, Bengal and Bihar Acts was passed by the Legislative Council of the Central Provinces and brought into force on the 1st September, 1934. The preamble points out that the Act is meant to regulate the grant of State-aid in various forms to industries and provision has been made for the creation of a Board of Industries with the Minister of Agriculture as President. The Act closely follows the lines of such legislation in the other provinces. The forms of State-aid which may be given are the grant of a loan, the guarantee of a cash credit, overdraft or fixed advance with a bank, guarantee of a minimum return on the whole or part of the capital of a joint-stock company for a fixed period, grant on favourable terms of land, raw material, firewood, water or any other property of the Local Government, grant free of charge or on favourable terms of the services of experts or Government officials, payment of subsidy for the conduct of research or the purchase of machinery. The industries eligible for State-aid in any of these forms are of the same kind as those in Bengal, Bihar and Madras. The amount of loan to be granted, the nature of security for the loan,

[1] Annual Administration Report, Department of Industries, Bengal, 1936-37, p. 41.

methods of recovery and inspection, etc., follow the same lines as elsewhere.

Bombay :

Following the sanction of the Bombay Legislative Council, the Government of Bombay framed rules in 1935 for affording financial assistance in the form of loans to the small industries for the construction of buildings, wells, tanks, etc., and for the erection of machinery and purchase of raw materials. The Director of Industries is to grant loans for amounts not exceeding Rs. 2,000. Loans involving sums beyond that amount will require the sanction of the Government. The maximum loan that may be advanced to a single person has been fixed at Rs. 10,000. The borrower is to hypothecate his block capital and may also give other collateral securities.[1] No State-Aid to Industries Act is in force in Bombay.

Before the framing of these rules the Government of Bombay had rendered financial assistance to industries to some extent through the Co-operative and Industries Departments. Loans and supply of implements on the hire-purchase system had been made through Co-operative Societies.[2] In 1922-23 the Government had sanctioned a loan of Rs. 5,000 without interest to Mr. Tikekar of Sholapur to enable him to erect buildings near his weaving factory.[3] The Government had also granted a loan of 6 lakhs of rupees to the Belapur Sugar Company at 6½% in May, 1926, the loan being repayable in May, 1931. The factory repaid its dues in full.[4]

Punjab :

In the Punjab, an Industrial Loans Act was passed in 1923 and it was hoped by this means "to be able to render

1 *The Indian Economist*, July 8, 1935, p. 493. Also *State Action in respect of Industries*, 1928-35, pp. 40-41.

2 Report of the Bombay Provincial Banking Enquiry Committee.

3 Report of the Department of Industries, Bombay, 1922-23, p. 16.

4 The Sugar Industry Enquiry (Tariff Board), Written Evidences, Vol. I.

direct financial assistance for the development of industries while amply safeguarding the public money involved." [1] The assistance to be given under this Act was limited to only one form, *viz.*, loans. The maximum and minimum loans that could be given were Rs. 5,000 and Rs. 500. Applications for assistance were to be received by the Director of Industries who would verify whether the security offered was sound or not. There was no system here of requiring the previous recommendations from a Board. Loans were usually granted with a security at least double the value of the loan of which a substantial proportion should consist of immovable property. No loans, however, were given under it in 1924-25 and in 1925-26. It came to be used from the financial year 1926-27 when 15 applications were received for the grant of loans. Six of these were sanctioned, each applicant receiving Rs. 5,000.[2]

In 1928, 42 applications for loans were received for the grant of a total amount of Rs. 1,86,000. Twelve applications were granted amounting to Rs. 54,300.[3] One was recommended to the Government for the loan applied for exceeded Rs. 5,000. In 1931, it was reported that out of 73 applications, 34 were granted, the total amount of the loan being Rs. 74,650. In 12 cases individual loans were below Rs. 1,000 indicating that small and cottage industries were receiving attention. Since the introduction of the Act up to 1931, the Government advanced a total sum of Rs. 3,61,950 to 112 applicants. Of this Rs. 81,535 were repaid by way of principal and Rs. 20,577-1-0 by way of interest.[4] Two cases were filed in courts for the realisation of the amounts due. In 1932, 28 applications for loans out of 58 received were granted amounting to a lakh of rupees. Thus it is found that up to this year the total amount advanced under

[1] Report of the Department of Industries, Punjab, 1923, p. 2.
[2] *Ibid.*, 1927, p. 7.
[3] *Ibid.*, 1928, p. 7.
[4] *Ibid.*, 1931, p. 6.

the Act amounted to Rs. 4,61,950 among 140 applicants.[1] During 1932-33, 63 applications were received of which 23 loans amounting to Rs. 75,000 were made under the Act. The industry which benefited most was the manufacture of sugar by the open pan system, loans for which amounted to Rs. 21,500.[2] The industries which have been assisted by the Government under the Act are of a wide variety. The statement given below indicates the total amount of loans advanced under the Act up to the year 1933, and the names of the various industries which received them.[3]

Name of Industry.	Total amount advanced. Rs.	Number of persons to whom advanced.
Weaving ...	86,000	30
Hosiery ...	58,850	21
Leather tanning and allied industries	41,100	22
Sugar ...	30,500	9
Furniture and carpentry ...	29,300	8
Tennis gut and sports gear-making	32,000	4
Calico-printing and bleaching ...	23,000	7
Oil milling ...	20,500	3
Type block making and tin-printing	26,000	5
Cutlery ...	19,000	4
Motor Engineering ...	18,000	5
Manufacture of drawing instruments	15,500	4
Pottery and chalk ...	15,000	4
Metal work ...	15,000	4
Rosha oil ...	10,000	2
Dairy farming ...	10,000	3
Chemicals ...	9,000	3
Comb making ...	5,000	1
Film industry ...	5,000	1
Cigarette making ...	5,000	1
Jam making ...	5,000	1
Durree making ...	5,000	1
Picture frame making ...	5,000	1
Harmonium making ...	4,000	1
Cosmetic goods making ...	4,000	1
Ribbon weaving ...	4,000	1
Sword and lance making ...	3,500	2
Chiken dozi ...	3,000	1
Ink making ...	2,000	1
Paper industry ...	2,000	1
Total	5,04,250	152

1 Report of the Department of Industries, Punjab, 1932, p. 11.

2 Government Review on the working of the Department of Industries, Punjab, for the year ended 31st March, 1933.

3 Proceedings of the Fifth Industries Conference, 1933, p. 18.

The Punjab Provincial Banking Enquiry Committee reported that a large majority of the artisans could not take advantage of the industrial loans under the Act as they were unable to offer adequate security.[1] The Committee made certain suggestions to modify the rules and regulations governing the grant of loans under the Act. The value of securities offered by the borrower might be reduced from one and a half to one and a quarter times; the existing rate of interest on small loans not exceeding Rs. 500 might be reduced to the borrowing rate of the Government and the recipient of small loans might, if possible, be exempted from registration and other procedures required under the Act.[2] The Act might also be made more useful to the artisans and the small industrialists if provisions could be made for the loan of machinery on the hire-purchase system.

In 1935, the Punjab Industrial Loans Act was superseded by a new State-Aid to Industries Act. It permits aid to be given to industries needing revival or development of modern methods in addition to the classes of industry referred to in other Acts. During 1937-38, two lakhs of rupees were disbursed in 35 cases as compared to Rs. 99,275 in 1936-37 and Rs. 94,000 in 19335-36.[3]

United Provinces:

Since 1921 the Government of the United Provinces have rendered financial assistance to industries in two ways by making (1) grants and (2) loans. As regards grants a sum of money varying between Rs. 15,000 and 35,000 is annually placed at the disposal of the Board of Industries which is a semi-non-official body for giving grants for any genuine industrial purpose, chiefly to pioneer industries for any purpose required by them but generally for the purpose of machinery on a half and half basis. The system, however, has not proved suitable for the development of bigger pioneer industries. Between 1921-22 and 1932-33, the

1 Report of the Punjab Provincial Banking Enquiry Committee, p. 291.

2 *Ibid.*, p. 298.

3 Report of the Department of Industries, Punjab, 1938, p. 23.

total amount of grants sanctioned by the U. P. Board of Industries was Rs. 1,25,608-3-10, the Budget allotment being Rs. 3,14,900.[1] As regards loans, a Board of Industrial Loan Commissioners was established in July, 1922, to supply principally small industrialists with capital upon easy terms.

The Board was the outcome of the recommendations of a committee appointed by the Government under the chairmanship of Sir Thomas Smith "to examine and make recommendations upon the subject of establishing an Industrial Bank in the United Provinces." It was constituted to receive applications for loans from all classes of individuals and corporations engaged in industrial development, whether pioneer or not. The Government would place a lump sum of money at the disposal of the Board with the consent of the Legislature for the purpose of granting industrial loans. Factory employees would usually be employed for purposes of valuation. The Board could not be legally empowered to sanction the loans but were assured that in most cases their recommendations would be accepted without further scrutiny. These decisions were endorsed subsequently by the Burn Committee in 1924. At its first meeting held in November, 1922, the Board considered 13 applications and recommended four of them involving a disbursement of Rs. 1,70,000. But three of the applicants did not take up the loans and the fourth did not comply with the conditions. In March, 1923, the second meeting was held. Three out of five applications were recommended, the total amount being Rs. 52,000, of which the Agra Pencil Factory received a loan of Rs. 10,000. The Budget of 1922-23 had included 5 lakhs of rupees for industrial loans. About a lakh out of this was spent at the end of the year.[2]

1 Report of the Industries Reorganization Committee, 1934, p. 61. Also App. VI, p. 42A.

The Board's composition :—(1) Financial Secretary to Government (Chairman), (2) Registrar of Co-operative Societies, (3) Mechanical Engineer to Government, (4) Director of Industries, (5) A member of the Board of Industries elected by the Board, (6) A member of the Upper India Chamber of Commerce, (7) A member of the U. P. Chamber of Commerce, (8) A representative of the Imperial Bank, (9) A representative of Joint-Stock Banking.

2 Report of the Director of Industries, United Provinces, 1922-23, pp. 6-7, p. 24.

In the next year (1923-24), five applications for loans were recommended of which the Government approved of the following three immediately and reserved for further consideration the other two :—[1]

		Rs.
(1)	Mahalaxmi Sugar Corporation, Lucknow ...	1,20,000
(2)	U. P. Glass Works ...	50,000
(3)	Allahabad Law Journal for a type foundry ...	22,000

In 1926-27, the Board sanctioned Rs. 20,000 to a glass factory, Rs. 8,000 to a press and Rs. 5,000 to a sugar factory. The first two did not take up the loan and the third applied for a larger amount and hence the application was rejected. A loan of Rs. 7,000 was disbursed at the end of the year to a Brass Workers' Society at Khari for the purchase of raw material. A loan of Rs. 5,000 was also sanctioned to a scissors manufacturing factory but it was not prepared to take it on the conditions prescribed by the Government.[2]

In the year 1927-28, Rs. 5,000 was sanctioned to the Muttra Match Factory and Rs. 40,000 to a manufacturer of China-ware in Bareilly. Rs. 15,000 was paid in during the year and the remainder in the next year.[3]

The Government sanctioned in the following year Rs. 6,000 for assisting the Leather Industry, Rs. 15,000 for the Brass-Ware Industry and Rs. 8,000 for Disinfectant Manufacture.[4]

The total amount of industrial loans sanctioned by the Government during 1931-32 was Rs. 30,000, of which Rs. 10,000 was for developing a jam-making and fruit-canning industry at Ranikhet.[5] In the following table will be found a summary of

1 Report of the Department of Industries, United Provinces, 1923-24, p. 6.
2 *Ibid.*, 1926-27, pp. 10-11.
3 *Ibid.*, 1927-28, p. 7.
4 *Ibid.*, 1930-31, p. 21.
5 *Ibid.*, 1931-32, p. 10.

all the loans advanced by the Industries Department in every year since 1917-18 to the various industries of the provinces.[1]

Classified Abstract of Loans Advanced by the Department of Industries, United Provinces.

Name of Industry.	Name of Recipient.	Year of Sanction.	Amount Advanced.	Total Amount for the Industry.
I. Sugar	1. Karandia Co., Lucknow	1922-23	6,00,000	7,20,000
	2. Mahaluxmi Co., Lucknow	1924-25	1,20,000	
II. Flour Milling	1. Coronation Mills, Allahabad	1919-20	20,000	42,00,00
	2. Karandia Co., Lucknow.	1922-23	4,00,000	
III. Glass	1. Mr. Varshani Bajori	1917-18	20,000	1,76,000
	2. Naini Glass Works	1920-21	16,000	
	3. Mr. Varshani	1922-23	1,00,000	
	4. Ditto.	1928-29	40,000	
IV. Bobbin Industry	Bobbin Co., Cawnpore	1925-26	80,000	80,000
V. Meto-China	Mr. Mirza, Roorkee	1927-28	40,000	40,000
VI. Dyes & Tanning Extract	Mr. Mirza, Bareilly	1917-18	30,000	30,000
VII. Type Casting	A. L. Journal Co., Allahabad	1924-25	22,000	22,000
VIII. Brass-Ware	Shannon & Co., Moradabad	1930-31	15,000	15,000
IX. Ink	Mr. Shukla, Cawnpore	1922-23	12,000	12,000
X. Match	Mr. Bhargava, Muttra	1925-26	5,000	10,000
	Ditto	1927-28	5,000	

[1] Report of the Industries Reorganization Committee, U. P., 1931. App. V, Table II, p. 40A.

	Name of Industry.	Name of Recipient.	Year of Sanction.	Amount Advanced.	Total Amount for the Industry.
XI.	Jam-making and fruit-canning.	Momtaz Hossain and Sons, Ranikhet.	1931-32	10,000	10,000
XII.	Disinfectants	P. Khandelwal & Co., Lucknow.	1930-31	8,000	8,000
XIII.	Tanning	Wali Mohammad, A. Razak, Agra.	1930-31	6,000	6,000
XIV.	Spinning	Mr. Bhagwat Prosad Srivastava, Basti.	1925-26	2,000	2,000
		Total	...	...	15,51,000

It will be observed from the preceding Table that the largest measure of assistance went to the sugar, glass and flour-milling industries. The other industries which were also financially assisted were type-casting, printing ink, jam-making, brass-ware, match, tanning, meto-china, manufacture of disinfectants, of bobbins and of dyes, etc. Out of the total sum of Rs. 15·51 lakhs advanced, there were 14 large loans (exceeding Rs. 10,000) amounting to Rs. 15·15 lakhs and six small loans totalling Rs. 36,000.

The affairs of the State-aided concerns have been as disappointing here as they have been in the case of Madras and Bihar. As early as 1925 the Lucknow Sugar Works owed as arrears of interest Rs. 1,76,000; the Karandia Development Corporation went into liquidation in 1927; the Mahaluxmi defaulted and fell into arrears. The bobbin factory fared no better. The glass works alone were able to pay regularly but even here it cannot be said that the loan achieved its purpose, *viz.*, the establishment of the manufacture of sheet glass.[1] Experience in connection with the large loans has been almost uniformly unsatisfactory. Out of Rs. 15·15 lakhs advanced in this way, Rs. 8,74,322 have had to be written off as irrecoverable; while

[1] A. Clow, *The State and Industry*, Ch. XII, p. 109.

of the balance over Rs. 80,000 are still overdue. Some of the concerns to which smaller loans were advanced also defaulted. But experience in regard to the smaller loans has not been generally so unhappy; only Rs. 1,714-5-6, being the amount out of a total of Rs. 36,000, advanced had to be waived.[1] The number of applications for loans has been declining in recent years and the Board of Loan Commissioners was abolished on January 1, 1937.[2]

An important step was taken by the United Provinces Government when an Industrial Finance Committee, consisting of banking and commercial experts, was appointed in November, 1934. In their Report published in 1935 the Committee recommended the formation of two special institutions, one for financing the major and minor industries, and the other for assisting the cottage industries of the provinces. The former institution, to be called "the United Provinces Industrial Credit Bank, Ltd.," should be started with an initial authorised and issued capital of Rs. 25 lakhs. The Local Government should guarantee a dividend on the initial paid-up capital of the Bank at the rate of 4% free of income-tax up to a maximum period of 20 years. The business of the Bank should be[3]—

(1) to give long and short-term credit facilities to major and minor industries with a view to encouraging and assisting those engaged in industry;

(2) to lend money against sufficient security in the shape of fixed and floating assets;

(3) to give credit facilities to those engaged in major and minor industries, or for the establishment of new industries, under the guarantee of Government in the absence of adequate security, where Government is of opinion that such assistance

1 Report of the Industries Reorganization Committee, U. P., 1934, p. 55. Also App. V, Table I, p. 39A.

2 Administration Report of the Department of Industries, U. P., for the year ending 31st March, 1937, p. 10.

3 Report of the Industrial Finance Committee, U.P., 1935, pp. 22-24.

is necessary in the interest of the industrial development of the provinces;

(4) to underwrite, subscribe to and invest in shares of joint-stock companies registered in the United Provinces and connected with industries having prospects of attaining commercial proportions;

(5) to lend money on immovable property, bills of lading, documents of title, promissory notes of two or more parties, debentures, Government promissory notes, etc.;

(6) to encourage the purchase of machinery, materials, etc., on the hire-purchase system and to supply funds and give guarantees for that purpose.

In addition to the business set out above, the Bank should be free—

(*i*) to open current accounts only for those who have taken advances from the Bank. The public should not be allowed to open current accounts as it is not desirable that the Bank should incur demand liabilities of any nature, as its funds would be generally invested in long-term credits. It may, however, accept deposits for long periods from the public;

(*ii*) to discount bills, promissory notes, *hundis*, etc., and to open overdraft and cash credit accounts with or without security of persons directly or indirectly connected with Provincial industries.[1]

Causes of the Failure of State-Aid in India:

The history of State-aid to industry has not been happy in India. Indeed the results have been so disappointing that ideas are rapidly gaining ground that, after all, the principle of State-aid may be wrong. Before condemning the principle of direct financial aid to industry by the State, it is necessary to analyse carefully the reasons for its failure in the various provinces of the country. In the earlier stage there was very little experience to

[1] An "Industrial Credit Bank" has since been established by the Government of the United Provinces on the lines of these recommendations

guide the Department of Industries in working the Acts and the investments were unfortunately not carefully planned or selected. The Governments of Madras and Bihar made heavy commitments in a single concern, the Carnatic Paper Mills and the Indian Steel Wire Products, Ltd. The success of the working of the Acts came, in each province, to be bound up with the fortunes of a single concern; the risks were not spread out. The consequences of this imprudent policy could not but be disastrous. The failure of the concerns landed the two provinces in serious losses. Nothing has brought more discredit to the State-Aid to Industries Acts than this indiscreet policy of advancing so heavily to a single enterprise. It was against the fundamental principle of industrial financing.

Bureaucratic delay in the disbursement of loans under the Act has in no small measure contributed to the disappointing results. There was great delay in examining and valuing the assets of the business, in getting the recommendation of the Board of Industries and in the final decision of the Local Government. The scrutiny of the Agricultural and Industries Department and the Finance Department took a long time. Even when the Government finally decided to sanction a loan, there was inordinate delay in disbursing the amount sanctioned.[1] In many cases loans applied for and even sanctioned were not disbursed after a year and sometimes more than a year. The need for the loan might have disappeared by that time, the conditions of the market might have changed. Pressing obligations could not have been met and a golden opportunity might have been thrown away. Under the circumstances, it cannot reasonably be expected that the financial results of the Act will be happy.

[1] Several instances of the dilatory methods of the Government were quoted by a member of the Statutory Board of Industries, Bengal. On March 6, 1934, the Board recommended a loan of Rs. 500 to an applicant who wanted to improve his umbrella factory to enable him to turn out more umbrellas for the monsoon season. The loan was not sanctioned by the Government till August and then after waiting for sometime for the money which was not forthcoming, he withdrew his application.—Proceedings of the Bengal Legislative Council, March, 1935, p. 679.

Besides the uncertainties that frequently arose in interpreting certain sections of the Acts, there are other defects and limitations. In regard to hire-purchase, for instance, there is no provision in the Bihar and Orissa Act for collateral security and the Government has to take over the machinery on a month's notice from the hire-purchaser. The hire-purchaser is to pay only the instalments that have fallen due before the date and is absolved from further responsibility. But second-hand machinery, even in good working order, does not fetch more than 20 to 30 per cent. of its original value and consequently the Government has to suffer considerable losses. The Act should be amended in such a manner as to provide for collateral security and guard against loss owing to the premature termination of the hire-purchase agreement. The period of 20 years for the hire-purchase of machinery in the Bengal and Bihar Acts is also unduly long. After the lapse of 20 years all machinery becomes "scrap" and the Government cannot realise anything from its sale in the event of the bankruptcy of the industrial concern.[1] This period may very well be reduced to 7 or 10 years.

Lack of co-ordination in industrial policy between the Provincial and Central Governments has been to no small extent responsible for the unhappy history of State-aid in India. Direct financial assistance from the State is but one of the factors influencing industrial development. Lakhs of rupees lent by Provincial Governments will be powerless to build up an industry unless other conditions are fulfilled. The other conditions are tariffs, railway rates, currency and exchange. These are beyond the control of the Provincial Governments and are controlled by the Central Government. A benefit extended to the provinces under the Act may be nullified by the policy of the latter. There is no use in granting State-aid by the provinces while the Central Government is working tariffs, railway rates and exchange in a manner which will take away the

[1] S. C. Mitter (Director of Industries, Bengal)—*A Recovery Plan for Bengal*, p. 558.

substantial part of the aid. A closely co-ordinated industrial policy—a scheme of planned economy—is what is required to stimulate the industrial development of a country.

The most important cause of the failure of State-aid in India lies in the absence of a suitable and efficient machinery to disburse public funds after careful investigation. The satisfactory working of the Acts depends to a considerable extent upon the proper assessment of the credit-worthiness of the enterprisers applying for State-aid and upon the careful estimate of the prospects and soundness of their business. The task is not at all an easy matter and requires a special machinery for its fulfilment. Under the various provincial Acts the Board of Industries (the Board of Loan Commissioners in the United Provinces) which meet together from time to time to examine applications for State-aid has been entrusted with these responsibilities. But the Board is not sufficiently competent to judge of the credit-worthiness of the applicants or the financial aspect of the risk involved in granting the aid. The Board is a large and heterogeneous body and cannot examine applications for loans with the thoroughness they require. The members of the Board are men of affairs and must be very busy on their own account. They are unable to devote their whole time or attention to the task. The fact that in many cases meetings of the Board could not be held for want of a quorum, is sufficient indication of the lukewarm interest taken by the members in the matter. Neither the Board nor the Department of Industries possesses the adequate experience, organisation or machinery for discharging its responsibilities. The Department is more concerned with the improvement of processes, appliances and technique of industries rather than their financial requirements. It has thus been called upon to undertake the responsibilities of a task for which it is not qualified. Undoubtedly in many instances the character and capacity of those who applied for State assistance could not be said to be properly suited to the enterprises they ventured upon. The Director of Industries,

Bihar and Orissa, stated before the Provincial Banking Enquiry Committee that a great many of the applicants could not be said to have satisfied all the tests of sound businessmen. This fact might be the reason why they could not raise their required finances from the ordinary sources and finally came to Government for accommodation inspite of the blaze of unwelcome publicity to which applications for aid were exposed under the Act. Applications exceeding a certain amount, it will be recalled, are required to be advertised in the Gazette. This, though necessary to protect the interests of the taxpayers, is calculated to injure the credit of the applicants. It is not improbable, therefore, that the persons who apply for State-aid are not usually those who are able to procure accommodation elsewhere. The Act may have unwittingly prevented enterprising businessmen from taking advantage of the facilities granted under it and may have unwillingly assisted the "lame ducks," the inefficient and the imbecile in business. This charge may be levelled even against the Indian Steel Wire Products Company. Its head office was in Bombay and a sound proposition seldom lacks money in a city like Bomay.[1] A lhrge number of instances has already been cited where the applicants did not take up the loans after they were granted; they did not even know their own minds. In several other cases they were unable to turnish sufficient security or supply to the Government all the necessary information required under the provisions of the Acts.[2] All this is an illuminating commentary on the character of the businessmen seeking aid. The financial result of the extension of aid to such types cannot but be disastrous. Under the circumstances it is desirable that the Government should relieve the Department of Industries of these heavy responsibilities and vest them in the hands of a

[1] Evidence of the Director of Industries, Bihar and Orissa. See Bihar and Orissa Provincial Banking Enquiry Committee, Vol. II, p. 214.

[2] During 1937-38 out of the 15 applications for loans made to the Bombay Government, 14 could not be considered for this reason. (See Annual Report, Department of Industries, Bombay, 1937-38, p. 26.)

more suitable organisation. Properly speaking, these are the functions of a bank. A bank will in the first instance be able to exercise more commercial supervision of the money that the Government is spending than it is possible for the Department of Industries. It will also be able to judge more adequately the credit standing of the applicants for State-aid, their managerial capacity and the prospects of their industrial propositions. The Director of Industries, Bihar and Orissa, rightly observed before the Provincial Banking Enquiry Committee that "the decision whether a particular industry should be financed or not ought to be taken out of the hands of the existing Board of Industries and placed in the hands of a bank."[1]

Lastly it may be observed that the State-Aid to Industries Acts were launched under one of the most severe depressions the business world has ever known. The post-war boom was succeeded by a widespread slump and during the past few years an economic blizzard of unexampled intensity was sweeping over the whole world. Industries of every description, private as well as State-aided, suffered under it. The unhappy affairs of the State-aided concerns should not prompt one to believe that they were the only ones to suffer. As a former Director of Industries, Bengal, observed: "It must not be forgotten that private industrial enterprise has been equally barren of adequate results and has failed to establish new industries of any substantial importance except when special tariffs have secured protective markets for them."[2]

State-Aid to Industries in the Native States in India:

In sharp contrast to the disappointing results of State-aid in the various provinces of British India, however, the Native States have been carrying on a remarkably successful policy of State assistance to industries. The definite attitude of moral

[1] Evidence of the Director of Industries, Bihar and Orissa, Vol. II, pp. 206-7.

[2] "Industry and State"—an article by Mr. A. T. Weston, M.I.C.E., M.I.E., Director of Industries, Bengal, in *The Capital*, Trade, Industries and Transport Supplement, 1931, p. 9.

support and the all-round policy of encouragement adopted by the States have a great deal to do with this achievement. The industrial policy of the States has suffered no handicap from the division of functions between Central and Provincial Governments as in British India. This lack of co-ordination between the Central and Provincial Governments in regard to industrial policies and the consequent absence of an all-round policy of State encouragement were, as already noted, to a great extent responsible for the failure of State-aid in British India.

Mysore :

Mysore easily comes first in the matter of State encouragement for indigenous industries. There is no other State which has adopted a more enterprising policy of State-aid for its industries or has achieved a greater measure of success in that field. Ever since the Mysore Government framed rules in 1913 [1] "for the grant of loans to facilitate industrial and agricultural operations," it has followed an active policy of State-aid to industries. It has established institutions under its own management, such as the Government Soap Factory and the Metal Factory; has carried on experimental and investigation work; and has assisted industry in every possible way. The granting of loans for the purchase of machinery for industrial purposes and sometimes also for working capital has been a special feature of the State policy.

The Government has taken shares in some concerns or given guarantee to private banks to advance loans to the concerns.[2] The mill industry, now one of the most flourishing industries in the State, has been assisted by loans, advances and cash credits. A cotton mill received Rs. 8 lakhs through the Mysore Bank in the form of a cash credit. [3] Two woollen mills were specially assisted either directly or through the Bank

[1] Revised later in the light of subsequent experience.

[2] Proceedings of the Industries Conference held in Simla, July, 1933, p. 22.

[3] *Ibid.*, p. 26.

of Mysore. The Mysore Yarn Co., Ltd., the Mysore Premier Metal Factory, the Mysore Pharmaceuticals, Ltd., the Art Litho Press, the Tirthali Tile Factory, the Aryan Hosiery Factory are some of the industrial concerns financially assisted by the Government.[1] The Department of Industries has started by loans or otherwise a number of flour mills, rice mills, pumping plants, etc. It has also assisted cottage and small industries and is reported to have been responsible for bringing into existence in various parts of the country nearly 500 concerns owned by small capitalists.

The industrial loan policy of the Mysore Government has been attended with singular success. The Government has lost very little money. Since the introduction of the policy of financial aid in 1913, the total amount sanctioned in respect of industrial loans up to 1930-31 was Rs. 14,35,124-3-6 of which Rs 9,64,032-9-11 was recovered and only Rs. 54,803-2-10 was written off.[2]

Mr. Collins, C.I.E., I.C.S., a former Director of Industries in British India and afterwards the Director-General of Commerce and Industry, Hyderabad State, pays a high tribute to the successful industrial policy of the Mysore Government in the following words:—" The State has shown that active encouragement of industry can be undertaken without loss of public money and to the great benefit of the country." [3]

Hyderabad:

A Department of Commerce and Industries was established in Hyderabad in 1918 and since then the State has been rendering financial assistance to industries. It created in 1919 an Industrial Trust Fund of a crore of rupees for granting State-aid

1 See Report of the Administration of the Department of Industries and Commerce, Mysore, 1919-20, p. 9.

2 Report of the Administration of the Department of Industries and Commerce, Mysore, 1930-31, p. 4.

3 " Industrial Policy in the Indian State"—an article by B A. Collins, C.I.E., I.C.S., in *The Capital*, Trade, Industries and Transport Supplement, 1932, p. 58

to industries. The fund is controlled by a Board consisting of 3 members of the Executive Council including the Finance member as Chairman. Power has been delegated to this body, "to utilise the corpus of the fund for loans to big industries and to spend the income in various other ways without reference to any further authority." The fund has been invested chiefly in industrial debentures and in some cases in ordinary shares also. The income from this investment is used in the development of cottage industries, propagation of technical and industrial education and granting of loans to small industries at 6% interest. The policy has not been unsuccessful and bad debts have not been many.[1] The investments from the Industrial Trust Fund have yielded a full return except in one case, *viz.*, a glass factory. The State invested Rs. 30,000 in the concern but it went into liquidation. Among the large-sized industrial enterprises financially assisted, the Shahabad Cement Works may be mentioned. It was helped with a loan of Rs. 12 lakhs at 8% interest. It is now in a flourishing condition. As regards small industries, fairly good recoveries have been made except in a few instances where the valuation of the land given in security was defective. The amount lent to these industries totalled in 1933 nearly Rs. 5 lakhs, of which more than half has been recovered.[2]

Baroda :

The history of State-aid to industries in Baroda dates back to 1891 when a sum of Rs. 1,50,000 was set aside for granting loans to small industries. The amount was subsequently increased to 3 lakhs. During the Swadeshi movement, when new industries were started all over the State, the Government liberally assisted every venture in every possible way. In 1906 the Department of Industries and Commerce was organised and rules were framed to grant loans to industries two years after.

[1] Article by B. A. Collins, *op. cit.*

[2] Proceedings of the Industries Conference held in Simla, July, 1933, p. 28.

The Bank of *Baroda was established about* the same time. The Bank was expected to grant long-term loans to industry but this expectation was not fulfilled. In 1915 the Government set aside a sum of Rs. 15 lakhs for loans to new industries at low rates of interest. The Bank of Baroda was also asked to advance loans to industrialists on the condition that the State would place with the Bank an equivalent amount at a lower rate of interest to meet the risk assumed by the Bank. The commission received by the Bank for the risk it undergoes in financing industry with long-term loans amounts to $1\frac{1}{2}\%$. The experiment has been found to be highly successful. The loss of State money has not at all been serious. Out of a sum of Rs. 20 lakhs only Rs. 43,000 have been lost so far, excluding one case when a debenture loan of Rs. 10 lakhs was given to a cement works.[1]

Gwalior :

In the State of Gwalior the Durbar has granted, besides many concessions, direct financial aid to industrialists in the shape of debenture loans. The cotton mills received as loans from the Government a sum of Rs. 34 lakhs. The loans were made out to four mills as follows :—

		Lakhs of Rs.
1.	Jayajee Rao Cotton Mills, Gwalior	... 18
2.	Binod Mills, Ujjain	... 8
3.	Nazar Ali Mills, Ujjain	... 5
4.	Sipra Mills, Ujjain	... 3
	Total	... 34

According to the Trade Member of the State, the results of state-aid to the weaving industries have been quite satisfactory in Gwalior. But in the case of smaller industries loans amounting to Rs. 10 lakhs had to be written off. The investment of Rs. 22 *lakhs in the two State-owned factories of pottery* and

[1] Proceedings of the Industries Conference held in Simla, July, 1933, p. 28. See also Article by Mr. Collins in *The Capital* Supplement, *op. cit.*

[2] Proceedings of the Industries Conference held in Simla, July, 1933, p. 23.

leather has also been unsatisfactory owing to Japanese competition.[1]

Travancore:

In Travancore State, a sum of Rs. 50,000 is provided every year in the budget for the encouragement of small industries. The Director of Industries is permitted to grant loans up to Rs. 25,000 with no further reference to the Government. Loans are given only on property securities valued by the Staff of the Revenue Department. The Government has subscribed to a portion of the share capital of a sugar factory which has been working fairly satisfactorily since 1932. Some of the oil mills in Aleppy and other places also approached the Government for loans as they were hard hit by the prevailing economic depression and a sum of about of Rs. 50,000 was sanctioned in 1932. An Industrial Loans Regulation was also passed in the same year with a view to providing funds for granting loans to cottage workers as well as to large-scale industries. According to the Director of Industries of the State, the experience of loans granted on the security of property has not been unsatisfactory.[2]

1 Proceedings of the Industries Conference held in Simla, 1933, p. 27.

2 *Ibid*, pp. 22-23.

CHAPTER VIII

State-Aid to Industry Abroad in Post-war Years

During the post-war years, the theory and practice of state-aid to industry has developed considerably and in many countries has come to form an integral part of Government policy. There has been a definite breakdown of the policy of *laissez-faire* in industry which dominated so strongly the nineteenth century thought and practice. A study of the methods by which and the conditions under which the State is assisting industry elsewhere will prove to be not only interesting but also highly instructive. The forms in which state-aid, both direct and indirect, has been furnished are various, all of which do not fall within the strict purview of our survey. We are concerned here only with one such form—direct financia lassistance, by which we refer to assistance in the form of loans with or without interest, subscription to share and debenture capital, grants, subsidies, guarantee of interest and the like. The space at our disposal does not permit us to undertake a detailed survey of state-aid to industry in all the different countries of the world. We shall confine our immediate interest to a study of the policy of State financial aid in a few selected countries, sufficient to give an indication of the growth and development of the practice of state-aid in recent years. Our attention will be directed particularly to a review of the legislation providing for state-aid to industry in post-war years. It will be found that in some instances such legislation bears a close analogy to the State-Aid to Industries Acts in India, and may indeed have inspired them. An attempt will be made to find out how far the working of such laws has been attended there with success from the view-point of the economic development of the countries concerned as well as from that of Govern-

ment finances. Among the Empire countries, the Province of British Columbia in Canada, the State of South Australia and the State of Victoria in Australia are remarkable for placing on their Statute books in the post-war years elaborate laws for the provision of State financial aid to industry. It is in the fitness of things that a study of post-war state-aid to industry should begin with a detailed review of the legislation enacted in each of these three countries.

I. *The Province of British Columbia (Canada)* [1]

In the Dominion of Canada, the province of British Columbia passed in 1919 an Act entitled "The Department of Industries Act" for the purpose of giving financial aid to industries. The aid was to take the form of a loan, guarantee or guarantees of securities on approved plans and the enterprises to be assisted were to be such as "to encourage the economic and commercial manufacture of the natural products of the province."

Plans, submitted by representative bodies of returned soldiers of British Columbia for promoting and providing for employment through the establishment of new industries and the development of existing industries, were also to be considered and dealt with.[2]

An Advisory Council was appointed under the Act by the Lt.-Governor in Council, consisting of not more than 7 members, representative of the commercial, financial, industrial, manufacturing and labour interests of the province.[3] Financial aid in any of the forms mentioned above would be granted to any person, partnership, association, company or corporation by the Minister of Industries upon the recommendation of the Advisory Council

[1] The Hon'ble Minister of Industries and Finance, and the Deputy Minister of Industries, British Columbia, furnished the writer with the Annual Reports of the Department of Industries, copies of the Department of Industries Act, 1919 and other documents, and also replied to detailed questionnaires.

[2] Section 4, The Department of Industries Act, 1919, C. 31, S. 1.

[3] Section 5 (1).

and with the approval of the Lt.-Governor in Council. It will be observed that the Columbia Advisory Council, its composition and its functions closely resemble the Statutory Board of Industries in the Indian Acts. The object of such assistance was to promote and develop industries and manufactories.[1] An industrial development fund was created consisting of such moneys as might be appropriated by or under the authority of the legislature for the purposes of this Act and all sums received by way of interest on or repayment of any advance made by way of loan pursuant to this Act.[2]

For the purpose of this Act, a provincial Industrial Loan not exceeding $2,000,000 might be raised or borrowed by the Lieutenant-Governor in Council by the sale of debentures, treasury bills or notes or by the issue and sale of British Columbia Stock under the provisions of the "Inscribed Stock Act." Treasury bills or notes might be renewed and re-issued from time to time and the amount outstanding on any original or renewed treasury bills, etc., might be converted into debentures or British Columbia Stock, but so as to be repayable not later than the 30th day of June, 1945.[3] All debentures, treasury bills, British Columbia Stock have to bear interest at a rate not exceeding 6% per annum to be fixed at the time of sale and to be payable half-yearly and repayable at a date not later than the 30th June, 1945.[4] The Minister of Finance might pay the interest accruing on all moneys borrowed for the purposes of the Act out of the consolidated revenue fund. A sinking fund might also be created for the repayment of every loan under this Act by annual appropriations of money by the Lieutenant-Governor in Council out of the general revenue of the province.[5] No financial aid would be granted under the Act unless the Minister of Industries and the Advisory Council were satisfied

1 Section 6.
2 Section 7 (1).
3 Section 12.
4 Section 13 (1).
5 Section 16 (1) and (2).

about the solvency, capacity and moral hazard of the applicant, his ability to make a fair profit, the earning powers of his business, the value of the security offered which was to be estimated on the basis of productiveness and finally that the proposed loan was desirable for any of the purposes of the Act and would be of economic benefit to the province.[1]

In the first meeting of the Advisory Council held on August 7, 1919, the methods of carrying on the business of the Department were outlined. The "Industrial Commissioner" appointed under the Act was to receive all applications for financial assistance. After making a full investigation on each application he would present a detailed report to the Advisory Council together with his recommendations for its consideration. The rate of interest on all loans was fixed at 6% plus any extra charge that the Government might have to incur in borrowing the money or in making the loan. When all conditions governing the grant of a loan were complied with, the amount of the loan would be placed in the Development Fund to the credit of the applicant. After the due registration and execution of the security papers had been completed, the applicant would receive payments from this Fund on voucher in accordance with the purpose for which the money was loaned. Thus the Department could be assured that all the moneys voted were used solely for the purposes for which the grant was made and were also used in the development of industry.[2]

Up to the end of 31st December, 1919, 225 applications for loans amounting to the value of $2,767,404·41 were received. Out of these only 19 applications were granted, the total amount of loans approved being $4,42,200.[3] During the next year (1920) the number of applications rose to 362 totalling in value $3,044,050. The total amount of loans approved was $630,658·48.[4]

1 Section 8.

2 First Annual Report of the Department of Industries, British Columbia, for the year ending 31st December, 1919, p. 5.

3 *Ibid*, 1919, p. 6.

4 Second Annual Report of the Department of Industries, British Columbia, for the year ending 31st December, 1920, p. 5.

More than 1,000 applications reached the Advisory Council up to the end of 1921. Altogether loans to 76 industrial concerns were recommended up to the close of the year; but ten of these could not comply with the conditions laid down by the Advisory Council and were, therefore, unable to take advantage of the financial assistance approved by it.[1] The total loans approved by the Department to 66 concerns up to the year 1921 amounted to $11,08,658. The loans were distributed among industries of various kinds and various sizes. Cordage, Toy, Bricks, Saw Mill, Boots and Shoes, Furniture, Boxes, Marine Engines, Ink, Cigar, Rubber Soles and Heels, Pickles, Fish Curing, etc. were some of the businesses assisted under the Act. The size of the loan varied from $250,000 to a Cordage Company in New Westminster (Canada Western Cordage Co., Ltd.) to $300 to an antique furniture concern in Victoria.[2]

In view of the prevailing industrial depression, the granting of financial assistance to industries had to be considerably curtailed in 1921. It was held that the establishment of new enterprises was not desirable when the industries already assisted were struggling to secure order. The Advisory Council decided to suspend the granting of further loans except to industries in which the Department had already an interest or those previously under advisement by the Board.

As regards the financial results of the state-aid granted under the Act, it is seen that at the end of 1921 the industries assisted by the Department were in arrears as follows[3]:—

Principal	$73,498·37
Interest	$22,100·57
	Total...$95,598·94

1 Third Annual Report of the Department of Industries, British Columbia, for the year ending 31st December, 1921, p. 5.

2 Third Annual Report of the Department of Industries, British Columbia, for the year ending 31st December, 1921, pp. 26-27.

3 Third Annual Report of the Department of Industries, British Columbia, for the year ending 31st December, 1921, p. 5.

Six enterprises repaid their loans in full, the total amount being $24,800.[1]

The repayments of principal and interest were rendered difficult not only by the general industrial depression prevailing at the time but also by the fact that in many instances they came at too soon a period after the launching of the enterprise to admit of proper development of the industry. Under the advice of the Advisory Council, the Minister of Industries granted extension of time in regard to the repayment of both principal and interest in the undertakings "where the persons connected with the business were showing a determined effort to fairly develop their enterprise without seriously impairing the security held by the Department.' "[2]

For the past few years no loans have been made under this Act. Approximately the sum of 2 million dollars was advanced by the Department under the Act up to the year 1933 when the Act was rescinded.[3] The Department remains in existence only for the purpose of winding up loans that are still outstanding.[4] As regards the working of the Act we can do no better than quote the following words from a letter of the Deputy Minister of Industries of the Province of British Columbia to the writer, dated the 7th March, 1934: "I have no hesitation in saying that the Department has filled a very important part in the upbuilding of industry in the Province of British Columbia and while certain loans made have not been repaid and never will be, there is no doubt that the loans so made were fully justified and taking the Act as a whole I might state that it has been very satisfactory."

II. The State of Victoria[5]

The Government of Victoria (Australia) passed on the 30th December, 1919, an Act called the Primary Products Advances

1 Third Annual Report, *op. cit.*, p. 28. 2 *Ibid*, p. 6.

3 Source: Letter to the writer from the Deputy Minister of Industries, British Columbia, dated 7th March, 1931, replying to a questionnaire framed by the author.

4 Source: Letter to the writer from the Hon'ble Minister of Industries and Finance, British Columbia, dated 12th December, 1933.

5 The Director of Finance, State Treasury, Victoria and the Director of Agriculture,

Act of 1919 (No. 3038) to provide for making advances to companies "for the purposes of undertakings for dealing with certain primary products." The undertakings referred to in the Act might be [1]:—

(1) Abattoirs and freezing works, chilling chambers and cool stores for meat;
(2) Cool storage for fish;
(3) Factories for the manufacture of canned fruit, dried fruit or jam;
(4) Flax Mills;
(5) Tobacco curing sheds and
(6) Fruit works.

The undertakings included the land upon which any works in connection with them were built and all buildings, erections, offices, conveniences and machineries in connection with them together with any additions or extensions. Applications for loans could be made by companies for constructing works, purchasing and installing machinery, acquiring by purchase or extending or adding to any such works or machinery and purchasing any land required in connection with any such undertakings as mentioned above.[2] No loans under this Act should be granted to any company unless a three-fifths majority in number and value of the shares in the company were held bona-fide by shareholders or members thereof being persons engaged in the production of any primary products supplied to the undertaking of the company.[3]

Every company applying for a loan should have to lodge with the Minister a deposit of at least £10 per cent. of the

Victoria, replied to a detailed questionnaire and furnished the writer with various documents relating to the operation of legislation authorising state-aid to industry in Victoria.

1 The Primary Products Advances Act, 1919 (No. 3038), Sec. 2. An Act called the Primary Products Advances Act, 1920 (No. 3068), was passed on the 28th September, 1920, to amend certain provisions of the Act of 1919.

2 The Primary Products Advances Act, 1919, Sec. 3.

3 Section 4.

amount of the loan applied for. The sum would be returned in the event of the loan not being granted but would be applied towards the repayment of the loan, if it were granted.[1] The amending Act of 1920 authorised the Treasurer to dispense with or reduce the amount of deposit on applications for loans.[2]

All applicants should supply a statement to the Minister setting forth the following [3] :—

(1) a copy of the company's memorandum and articles of association;

(2) evidence of its due registration;

(3) a description and map or plan of the locality where the works or proposed works in connection with the undertakings were or were intended to be constructed;

(4) the situation and cost or estimated cost of the site or proposed site of the works and of any other land purchased or proposed to be purchased in connection with the undertakings;

(5) the nature and cost or estimated cost of all buildings, machinery and other works erected, installed or constructed for or in connection with the undertaking;

(6) the period within which the company desired advances to be made and the instalments thereof required;

(7) any other matters as might be required by the Minister.

These applications were to be referred by the Minister to the Director of Agriculture and the Secretary for Public Works for report. When the reports would be presented to the Minister he was to consider carefully whether there was a reasonable probability of the undertaking being carried on successfully and whether the buildings and machinery were of a character and description properly suited to

[1] The Primary Products Advances Act, 1919, Sec. 5 (2).

[2] The Primary Products Advances Act, 1920 (No. 3068), Section 2.

[3] The Primary Products Advances Act, 1919, Section 5 (1).

the purposes for which they were intended.[1] If he was satisfied about these points, and decided that the loan should be granted, he would have to submit the application together with all documents connected therewith to the Treasurer. The Treasurer in his sole discretion but with the approval of the Governor in Council might grant a loan to the company under the Act out of any moneys legally available for the purposes. The Treasurer also would decide as to the terms and conditions of the loan.[2] The amount of the loan might be paid out either in one sum or in several instalments and should be repaid at such time and in such amount and with interest at a rate determined by the Treasurer.[3] An agreement was to be entered into *between the borrowing company and the Treasurer in the name* and on behalf of His Majesty, specifying the terms and conditions upon which the loan was granted, the manner in which advances were to be made, the time and the amount for repayment and the rate of interest. For the purpose of securing the repayment of the loan and interest and all moneys which, by the Act, the company was required to pay to the Treasurer, in the same agreement the company would also have to execute or cause to be executed or undertake that it would, whenever called upon by the Treasurer, execute or cause to be executed at its own cost and to the satisfaction of the Treasurer in addition to such other securities as the Treasurer thought fit (*a*) a first mortgage to His Majesty over the undertaking and the works and all such other property and assets and uncalled capital whatever of the company as determined by the Treasurer, *or*, (*b*) an assignment to His Majesty of all contracts and all right, title and interest to and in all such machinery and all such other property whatsoever purchased or contracted to be purchased up to the time of the payment of the advance or of each respective

1 The Primary Products Advances Act, 1919, Sec. 6 (1) and (2).

2 Section 7.

3 Section 8.

instalment of the loan and all such assets and uncalled capital whatever of the company as determined by the Treasurer.[1]

The effect of the execution of such assignment would be that His Majesty should be deemed to have a first mortgage and charge in priority to every other person over the machinery and other property, assets and uncalled capital, the subject-matter of the assignment, to secure the repayment of the money advanced by the Treasurer. Again all such moneys should be spent in accordance with the agreement and no instalments should be paid to the company unless all previous instalments had been properly spent.[2]

To enforce or satisfy the rights of His Majesty under such assignment or mortgage. His Majesty should have full right and authority to enter upon any land whatsoever and to whomsoever belonging and to remove therefrom any machinery or other property or assets, the subject-matter of such assignment or mortgage, and to do all other acts and things deemed necessary by the Treasurer.[3]

When a company obtained a loan under this Act which was utilised either wholly or partially in the purchase, erection or construction of buildings, machinery or any kind of perishable structure, it should pay every year, by way of a depreciation fund, a sum of money not exceeding £5 per cent. of the cost of such buildings, etc., into a Trust Fund until in the opinion of the Treasurer the balance to the credit of such fund was sufficient to cover the total cost of replacing the said buildings, machinery or perishable structure. The moneys standing to the credit of such fund should be available and be used for such repairs to or renewals of the said buildings, machinery or perishable structure as might be authorised by the Treasurer.[4]

1 The Primary Products Advances Act, 1919, Section 9 (1).

2 Section 9 (3) and (4).

3 Section 9 (6).

4 Section 10 (1) and (2).

In lieu of payments in respect of depreciation the Treasurer was empowered by the amending Act of 1920 to increase in every year, the amount the company was required to repay under Sec. 8, by such sum as he thought fit but not exceeding by £5 per cent. of the cost of said buildings, etc.[1] All works (properties, real and personal, all additions and improvements thereto) of the borrowing company must be kept insured against fire to their full insurable value with some Insurance Company approved by the Treasurer.[2] A company which obtained financial assistance under the Act must furnish to the Treasurer every year a balance-sheet in such form and containing such particulars as approved by the Auditor-General. The Treasurer had power to inspect and control the construction works as well as to examine books and documents and demand information which must be supplied within 14 days relating to the business of the company. He might also require any information furnished to be verified on oath by such Directors, Managers or other principal officers as thought fit by him. He had also the power to prohibit any action of the company which in his opinion was contrary to the provisions, meaning and working of the Act or the agreement, order the company to take any action and direct it to renew or repair its plant or machinery.[3]

In case of default on the part of a borrowing company, the Treasurer should give notice in the Government Gazette and in some other newspapers circulating in the neighbourhood of the undertaking of his intention to enforce compliance with the provisions of this Act. In the event of the default continuing even after the expiration of 14 days from the date of such notice, the Treasurer would appoint some person on his behalf to enter into full and absolute possession of the undertaking and the works

1 Every such additional sum was to be paid in half-yearly instalments. Depreciation Fund was not required also, provided the Treasurer directed, where a loan granted under the Act to a Company was to be repaid at a date not more than 10 years after the grant, Section 4, The Primary Products Advances Act, 1920 (No. 3068).

2 The Primary Products Advances Act, 1919, Section 11.

3 Section 12 (1)-(5).

and all other property of the company, and also to manage and conduct the working of the same, would appoint necessary managers, officers and servants and continue in such possession so long as the default continued. Such person appointed by the Treasurer would not only exercise some or all of the powers possessed by the Directors, etc., but also if directed by the Treasurer would cause the undertaking, the works and other property to be sold by public auction or tender or private contract and the moneys thus realised should in the first place be applied towards extinguishing any existing liabilities of the company to the Treasurer.[1]

In addition to the usual payments to be made to the Treasurer, any company receiving an advance under the Act should also pay every year such sums as would be deemed necessary by the Treasurer to re-imburse the expenses of the State in the carrying out of this Act or any agreement entered into with the company.[2]

The unpaid amount of any advance or any portion thereof should with interest remain a first charge on the undertaking, works, land and property and the profits, assets and uncalled capital of the company. No profits, dividends or bonuses could be divided among shareholders of the company in any year until all amounts previously due and payable pursuant to the Act had already been paid to the Treasurer.[3]

Any company which obtained a loan under the Act might with the Minister's consent enter into an agreement with the Board of Land and Works to have any works in connection with the undertaking erected and equipped by the said Board at its own expense.[4]

All liabilities of the company to the Treasurer should be a crown debt and all payments and remedies, therefore, would be

1 The Primary Products Advances Act, 1919, Section 12 (6).

2 Section 13.

3 The Primary Products Advances Act, 1919 Section 14

4 Section 16.

enforced in the name of His Majesty against the company and its assets in priority to all other persons.[1]

The Primary Products Advances Acts of 1919 and 1920 have since been repealed and the powers conferred under them have been vested in the State Savings Bank Commissioners of Victoria.[2] According to the State Savings Bank Act of 1928 the business of the Commissioners is to be carried on in two separate and distinct departments—the State Savings Bank Department and the Credit Foncier Department. In the Foncier Department the Commissioners have been empowered to issue from time to time debentures payable to bearer for the purpose of making advances or loans and providing dwelling houses.[3] The due payment of all debentures and of credit foncier debenture stock and of all interest thereon has been guaranteed by the Government of Victoria. The total sum for which debentures and debenture stock may be outstanding and unredeemed has been limited to £29 million.[4] The loans may be granted to :—

(1) companies for undertakings dealing with certain primary products,[5]

(2) companies in connection with certain industries in country districts,[6]

(3) companies for "stores."[7]

As regards the loans to be granted for undertakings dealing with certain primary products, the main provisions of the Primary Products Advances Acts of 1919 and 1920 have been embodied with slight modifications in the State Savings Act of

1 Section 15.

2 Sources : Letter to the writer from the Director of Finance, State Treasury, Melbourne, dated the 26th April, 1934, in which he replied to a questionnaire. Letter to the writer from the Director of Agriculture, Victoria, dated the 15th March, 1934.

3 *An Act to consolidate the Law relating to the State Savings Bank of Australia*, 12th February, 1929 (No. 3777), Section 69.

4 *Ibid*, Section 70.

5 Division 7, Secs. 116-20, No. 3777, Part III.

6 Division 5, Secs. 98-110.

7 Division 6. Secs, 11-15.

1928. All the powers of the State Treasurer in the original Acts have been transferred to the Savings Bank Commissioners. Among the provisions applying to a company which has received loans, there is found to be an additional sub-section that shares in the company must not be transferred without the previous consent in writing of the Commissioners. All transfer of shares in contravention of this proviso will be null and void.

In the case of any loan granted to a company by the Treasurer of Victoria under the Primary Products Advances Acts of 1919 and 1920, previously in force, the said Treasurer, notwithstanding the repeal of any such Act, may advance any instalment of such loan and may grant further loans to such company pursuant to the provisions of the Acts under which the original loan was granted and, until the original loan and all such further loans are with interest repaid in full, may exercise all powers given by the Acts applicable to the circumstances of the particular case and may by agreement with the Commissioners arrange for the receipt, collection and recovery by the Commissioners for and on behalf of himself of all repayments with interest thereon and of any other moneys due and owing to him in connection with the loan. For the purpose of carrying any such agreement into effect, the Commissioners may demand and receive from any company or person all moneys including repayments with interest thereon due and owing to the said Treasurer. Whenever such moneys remain unpaid, the Commissioners may "commence and prosecute all necessary and lawful powers, remedies, actions, proceedings, means for the recovery and getting in of the same to the same extent in all respects as the said Treasurer would have been authorised or entitled to do if such agreement had not been entered into."[1] The Treasurer and the Commissioners have both been empowered to waive the rights to enforce against the stock-in-trade and uncalled capital

[1] State Savings Bank Act of 1928, Section 114 (1) and (2).

of the company any claim in respect of a loan or a charge created by the Acts.[1]

The loans granted under the Primary Products Advances Acts of 1919 and 1920 up to 30th June, 1933, amounted to £331,154-10-2. These loans were granted on terms from 5 to 10 years, the average period being 10 years.[2] The loans were distributed among various Companies as follows [3] :—

		£	s.	d.
(a) 8 Meat Freezing Companies	...	2,61,090	5	0
(b) 2 Bacon Curing Companies	...	35,500	0	0
(c) 1 Butter Cool Storage Company	...	10,999	18	11
(d) 2 Fruit Processing Companies	...	22,564	6	3
Total	...	3,31,154	10	2

The rates of interest varied from 5½% to 7%. From 1st July, 1932, rates of interest exceeding 5% were reduced to 5% for a period of three years.

As regards the question whether the working of the Acts has been successful, the Director of Finance in replying to our questionnaire has written to us: "Whilst the aid given by the State has a certain economic value, the working of the Acts from the point of view of Government finances has not been very satisfactory."[4] The total amount outstanding on 30th June, 1933, was £258,890-4-3 made up of as follows [5] :—

		£	s.	d.
1. Interest	... ...	73,101	8	0
2. Redemption ...	... ...	1,26,194	15	10
3. Interest penalty for late payment of instalment		59,594	0	5
Total	...	2,58,890	4	3

[1] State Savings Bank Act of 1928, Sec. 116.

[2] Source: Letter to the writer from the Director of Finance, State Treasury, Melbourne, dated 28th April, 1934.

[3] Finance Statement, 1932-33, p. 141.

[4] Source: Letter to the writer from the Director of Finance, *op. cit.*

[5] Finance Statement, 1932-33, p. 141.

III. The State of South Australia [1]

Another instance of post-war legislation providing for State financial aid to industry is found in South Australia. A "Loans to Producers Act" was first passed in 1917 which was subsequently amended in 1919, 1921, 1922, 1924, 1925 and 1926. Finally in 1927 all these Acts were repealed and a consolidated Act entitled the "Loans to Producers Act, 1927" was passed by the South Australian Government. By the original "Loans to Producers Act (No. 1312)" of 1917 a Loans to Producers Board consisting of the Secretary to the Minister of Agriculture, the Director of Agriculture, the Agricultural Inspector, the General Manager, Produce Department and Under-Treasurer was appointed to deal with and report upon applications for assistance under the Act. Since the establishment of the State Bank of South Australia in 1925 the administration of the Loans to Producers Acts has been handed over to the Bank and all applications for loans have to be made to it. The Regulations made under the Loans to Producers Acts (1917-1926) empowered the Bank to make loans on prescribed security to two classes of borrowers: (*a*) Co-operative Societies, registered under the Industrial and Provident Societies Act of 1864 or of 1923, engaged or about to engage in rural production, and (*b*) Landholders.[2] The object was the encouragement of rural production and effective land settlement. All applications for loans under the Act by Co-operative Societies, or Landholders should be made in their respective prescribed forms. These applications were to be supported by a statutory declaration by the Secretaries to the Co-operative Societies and the Landholders themselves.[3] Any deed, certificate of title, lease, agreement or other document which might be required by the Bank would have to be produced free of charge by the applicant.

[1] All the State documents used in the preparation of this section were obtained from the Hon. Minister of Agriculture, South Australia, who also replied to a detailed questionnaire.

[2] Regulation No. 7.

[3] Regulations 2 and 4.

The Bank was empowered by the Act to grant loans for the following purposes[1]:—

(*a*) the erection of cool stores,
(*b*) the erection of factories for jam making and for canning, drying or otherwise preserving fruit or vegetables,
(*c*) the erection of fruit-packing sheds,
(*d*) the erection or purchase of butter, cheese or bacon factories,
(*e*) the purchase of fruit-grading machinery,
(*f*) the erection of silos,
(*g*) the erection or purchase of any shop or market for the sale of any rural products,
(*h*) the sale, whether by wholesale or retail, or the preparation for sale, of any rural products,
(*j*) clearing scrub or timber on land held under lease or agreement from the Crown,
(*k*) fallowing land held under lease or agreement from the Crown,
(*l*) the erection of wineries or distilleries,
(*m*) the making of additions to such cool store, factory, shed, machinery, silo, shop, market, winery, distillery, irrigation plant, barn or shed,
(*n*) the repayment of any loan (not being a loan under the Act) raised or used for purposes similar to (*a*)-(*k*),
(*o*) the installation of irrigation plants,
(*p*) the purchase of any cool stores, factory, shed or other building,
(*q*) the erection of barns or sheds for the curing or treatment of tobacco.

The purposes for which loans might be made under the Act were divided into Class A and Class B. Class A loans

[1] Regulation 6.

might be made to co-operative societies only and included (*a*), (*b*), (*c*), (*d*), (*e*), (*g*), (*h*), (*l*), (*m*), (*n*), (*p*), and (*q*). Class B loans, which included the purposes set out in (*f*), (*j*), (*k*) and (*o*), might be made only to land-owners.[1]

The period of Class A loans was fixed at 18½ years unless otherwise determined by the Bank. For the first six months of the currency of the loan, interest at the prescribed rate should be paid and the repayment of the principal money and the interest accruing thereon should be made in 36 equal semi-annual payments, the first of which would fall due on the first day of the 13th calendar month from the making of the loan. Of Class B loans, those for the purposes of (*f*) and (*o*) should be for 12 years. As regards the former, for the first six months of the currency of the loan interest at the prescribed rate should be paid and the repayment of the principal money and the interest accruing thereon should be made in 14 equal half-yearly payments. As for the latter, interest on the loan should be payable half-yearly for the first two years of the currency of the loan and repayment of the principal money and the interest accruing thereon should be made in 20 equal half-yearly instalments.[2]

Every loan to a Co-operative Society should be secured by a mortgage over the estate and interest of the Society in any land or the building thereon and the Society should, if the Bank so requests, in addition to giving a mortgage, grant a bill of sale or debentures over all such goods and chattels or other assets of the Society as the Bank might require. The Bank's guarantee of a Co-operative Society's overdraft as well as the loan to a landholder should be similarly secured.[3]

All applicants for the loans should pay the cost, wholly or in part, of any inspection of land or building in respect to which the application for the loan has been made. They should

[1] Regulations 7 and 8.
[2] Regulation 9.
[3] Regulations 10-12.

also bear the expenses of registration of any mortgage, debenture or other security.[1]

During 1922 to 1925 when the administration of the Acts was made over to the State Bank, the Cabinet, on the recommendations of the Loans to Producers Board, granted loans to 15 Co-operative Societies amounting to £141,640. The loans were distributed among these Societies as follows [2] :—

		£
8 Co-operative Fruit-packing Societies	...	39,076
4 Co-operative Cheese Factories	...	5,028
2 Co-operative Distilleries	...	94,536
1 Producers' Marketing Society	...	3 000.

The purposes for which the loans were advanced were for purchase of plant and machinery, erection of cool stores and packing and grading sheds, building of factories and even addition to rooms. Under the provisions of the amended Act of 1924, overdrafts of several Co-operative Societies were guaranteed. The actual overdraft on June 30, 1925, was £10,293-7-0 and the amount of guarantee £24,500.[3]

The Loans to Producers Act, 1927 was passed to consolidate the Acts of 1917 to 1926. The same provisions for securing the loans as in the original Acts have been made in the new Act.[4] The Loan to Producers fund which was first created under the Act of 1917 has been continued under the consolidating Act. The Treasurer sets apart to the credit of this fund such loan moneys as are to be provided from time to time by Parliament for the purpose, but not exceeding £10,000 in any one financial year.[5]

1 Regulation 17.

2 The data are obtained from the list of various concerns assisted year by year as given in the Reports of the Minister of Agriculture, for the years 1922 (p. 8), 1923 (p. 9), 1924 (p. 8), and 1925 (p. 5).

3 Report of the Minister of Agriculture, South Australia, for the year ended 30th June, 1925, p. 8.

4 The Loans to Producers Act, 1927, (No. 1802 of 1927), Sec. 8.

5 The Loans to Producers Act, 1927, Sec. 4 (1) and (2).

All sums received by the Bank in repayment of loans are paid to the Treasurer and form part of it. The Bank has been empowered to make loans out of this fund to Co-operative Societies and Landholders for nearly the same purpose as before.[1] The guarantee of the repayment of advances by another bank to a Co-operative Society in the form of an overdraft has also been provided for.[2] In case the loans are not carefully or economically spent, the Bank may stop payments of the instalments and may immediately recall the entire amount lent.[3] If a loan under the terms of the Act remains unpaid for 3 months after it has become due for payment, the Bank may enter upon and take possession of the land upon the security of which the loan has been made and may sell the estate or interest of the Co-operative Society or Landholder by private sale or private tender or auction. The sale proceeds should in the first instance be devoted towards the repayment of all dues to the Bank including expenses incurred by it in relation to the sale and the balance will then be paid to the owners.[4] The failure to pay interest within a notified period after due date for payment should be penalised by the Treasurer charging a higher rate than the usual one. The penalty rate will come into force on the fourteenth day after the date of the Government Gazette in which it is published.[5]

As already noted, the State Bank of South Australia has been administering the Loans to Producers Act since 1925. Up to 1932 financial assistance was granted to 22 Co-operative Societies as follows[6] :—

5 Wineries and Distilleries.	4 Butter and Cheese factories.
7 Fruit-packing sheds.	1 Producer's Marketing Society.
4 Cool stores.	1 Tobacco Barn.

1 The Loans to Producers Act, 1927, Sec. 5 (1) and (3).

2 Sec. 13 (1).

3 Sec. 9 (1).

4 Sec. 13 (1) and (2)

5 Sec. 9 (2).

6 Source: Letter to the writer from the Hon. Minister of Agriculture, South Australia, dated 11th December, 1933.

The loans have usually been granted up to 75% to 80% of the value of the security submitted. According to the Report of the Board of Management of the State Bank of South Australia, 1932, operations under the Acts were confined during the year to the matter of granting advances for the purpose of enabling settlers on the West Coast to clear land on their holdings. Loans were approved to 19 applicants covering an area to be treated of 4,670 acres and involving the sum of £2,307-10-0. Up to the 30th June, 1932, the sum of £44,364-11-5 was advanced for the above-mentioned purpose. There were 340 accounts open on the books and the balance outstanding on that date amounted to £227,223-18-1.[1]

As regards the financial position and financial records of the various Co-operative Societies to which loans were made under the Act, a number of them, it must be pointed out, fell into difficulties. During 1924 the Blackwood Fruit Producers' Co-operative Society defaulted in respect to the payment of interest on the loan granted to it[2] and continued to be unable to meet its principal repayments during the next year. The Minister agreed to defer the commencing date for repayment of principal, provided the Society put in new plant to reduce its heavy working expenses which were largely responsible for its difficulties. Another Society, the Springs Co-operative Cheese Company, became involved in serious financial difficulties and had to go into liquidation in the year 1925. According to a Report of the Minister of Agriculture, a great deal of the difficulties experienced by the borrowing concerns was due to the failure to keep proper books and to the employment of

[1] Report of the Board of Management of the State Bank of South Australia for the year ended 30th June, 1932, p. 5.

[2] Report of the Minister of Agriculture, South Australia, for the year ended 30th June,

unqualified auditors to audit the books.[1] In 1925 a provision was included in all mortgages under the "Loans to Producers Act" that within 30 days after the end of each financial year of the Society, a duly certified and audited statement by a public accountant, approved by the Minister and in such form as might be required by him, should be submitted by the Society. With the object of building up cash reserve funds, provision was also made for the Societies to set aside annually a sum equal to 1% of the loan which amount would have to be expended in a manner directed by the Minister. The money would remain the property of the Society but could not be expended except with the Minister's consent, the object being to build up a fund from which any unusual renewals or slight extensions to the building or plant could be effected when the ordinary funds at the disposal of the Company were inadequate for the purpose. A further provision to the effect that the books should be kept in accordance with the instructions of the Minister would, the Government believed, doubtless lead to better protection of its interests.

The general position from the financial aspect of the operations under the Act on 30th June, 1925, is indicated in the following statement submitted by the Chairman, Loans to Producers Board[2] :—

	£	s.	d.
Amount advanced up to 30th June, 1925 ...	124,975	17	3
Repayment of Principal	575	18	0
Arrears of Principal	797	16	6
Amount of Interest paid	6,819	5	10
Arrears of Interest	958	7	6

[1] Report of the Minister of Agriculture, South Australia, for the year ended 30th June, 1925, p. 8.

[2] Report of the Minister of Agriculture, South Australia, for the year ended 30th June, 1925, p. 8.

The revenue account as given in the Report of the State Bank of South Australia shows operations under Loans to Producers Acts since commencement to 30th June, 1932 [1] :—

	£ s. d.		£ s. d.
To interest charged by H. M. Treasury.	77,107 3 6	By interest ... receivable.	86,040 8 6
Interest written off	2,318 5 10		
Administrative expenses	3,692 9 9		
Flotation charges ... written off.	651 19 5		
Surplus ...	2,287 9 5	Rent Account ...	16 9 5
	£ 86,057 7 11		£ 86,057 7 11

As regards the question whether the working of the Acts has been successful, we can do no better than quote the following lines from a letter to the present writer from the Secretary to the Minister of Agriculture :—

"Although losses have been incurred through certain co-operative societies going into liquidation, the rural producer has been considerably benefited from the establishment of the co-operative societies." [2]

IV. *Spain* [3]

Spain offers an outstanding example of a European country which enacted in the post-war years a most elaborate piece of legislation for state-aid to industries. On April 30, 1924, a Royal Decree as to state assistance for industry was passed

1 Report of the Management, State Bank of South Australia, for the year ended 30th June, 1932, p. 16.

2 Letter from the Secretary to the Minister of Agriculture to the writer, dated the 11th December, 1933.

3 The writer approached the Consul for Spain in India (Bombay) and His Britannic Majesty's Consul in Barcelona for information relating to the working of state-aid to Industry in Spain. All the information that it has been possible to secure has been presented here.

replacing a similar law of 2nd March, 1917, which had ceased to operate on 31st December, 1922.[1] The industries to be assisted under the terms of the Decree were all agricultural and stock-raising industries, mining, steel and metal works, factories, industries for constructing buildings and for making railway material, hydro-electric and electro-thermic works and all subsidiary industries. The Decree empowered the Government to grant assistance for the purpose of aiding in the creation of new industries and the development of those already existing. Applications for such assistance were to be made during a period of 3 years from 2nd May, 1924, the period to be extended for further 3 years on the recommendation of competent authorities. According to the provisions of the Decree, the following industries were entitled to benefits under the Decree: (*a*) new industries, *i.e.*, industries which had for their principal object the supply of Spanish natural products and which were as yet non-existent or not fully developed, (*b*) existing industries whose production was sufficient in quantity or quality to supply the normal demand in the country, (*c*) industries whose surplus production was exported. Industries connected with national defence were to receive preferential consideration.

The applicants must be Spanish firms and must comply with the following rules :—

(1) In the case of limited liability companies one-third of the Board of Directors might be foreigners, but in the case of a sole trader, he must be of Spanish nationality as also the Managers and Directors or firms. No foreigner might be President of the Board or Managing Director.

(2) 75% of the capital must be owned by Spaniards whatever the constitution of the firm or organisation.

(3) 80% of the office-staff and workmen must be of Spanish nationality. During the first three years employment of foreigners would be permitted in the following proportions : 75%

[1] See Report of the Committee on Industry and Trade—Survey of Overseas Markets, 1926, p. 92.

during the first year, 50% during the second and 30% during the third.

(4) The fuel, material and fittings used in the installation and the articles employed by the protected industry must be of national production excepting when they had to be acquired abroad for technical reasons or owing to a difference in cost exceeding 15% or on account of proved urgency or when production in Spain was insufficient to meet the requirements of the country.

The state-aid furnished under the Decree was to take the form of (*a*) privileges, concessions or other advantages without direct economic assistance, or (*b*) loans made in conjunction with the Banco de Credito Industrial.

These benefits were to apply to new industries and existing industries where production was insufficient to meet the normal demand in the country. New industries might be given a guarantee of minimum interest on the capital invested in them, but then a loan would not be granted in addition.

Loans under the Decree were to be effected through the Banco de Credito Industrial for periods up to 15 years. The total amount lent was not to exceed 150 million pesetas.

In order to favour the establishment of large industries for which the above provisions did not provide sufficient inducement, a state guarantee of interest might be granted. This guarantee was only to be available for enterprises considered to be of national importance. The rate of interest provided was 5%. The guarantee was applicable solely to capital issued and paid up and would cover a period not exceeding 8 years. The maximum sum allotted for this class of payment was 10 million pesetas per annum. In the case of large industries of national importance the capital on which interest was guaranteed might be composed of shares and debentures to the extent of one-half of the total and only 25% of these shares and debentures could be transferred abroad. An industry protected by a State guarantee of

interest which was in a position to pay over 6% dividend on its shares must surrender half the profits earned in excess of this dividend to the State.

It was a condition of any concession that the position of the applicant industry should be declared and methods of works and machinery must be of modern character. In the case of a new industry an exclusive grant of assistance might be made for 5 years but the concession would be withdrawn if other firms in the same industry introduced more advanced processes or accepted less protection.

The Decree further stipulated that state-aid should not be given to any industry if that industry was thereby enabled to compete with a similar pre-existing industry, and provided that petitions might be submitted to the competent department by the industry likely to be prejudiced; but such protest must be accompanied by proofs that the complainant enterprise was being developed on modern lines.

The Banco de Credito Industrial, founded by the State in 1920 with a capital of £37,500,00, was used under the provisions of this legislation for furnishing long-term loans to industry for such purposes as installation of plant and machinery, erection of factory, etc. Of every such loan advanced, the State contributed 80% and the Bank 20%. The necessary funds were obtained by issuing bonds up to a maximum of 150,000,000 pesetas. It has been estimated that up to 1933 such long-term loans made to industry totalled 100 million pesetas.[1] But the policy of state assistance did not prove to be much attractive to the industrial borrowers of Spain. The private banks there appeared to offer less onerous terms for their loans. There was, further, an elaborate process of reference to various Government departments to which every loan was subject, and applications had often to await sanction for as long as a year. All this served

[1] "The Banking System of Spain"—an article by H. L. Dark in *The Banker*, June, 1933, p. 169.

to keep away many would-be borrowers of the Bank from taking advantage of the opportunities and the Bank unfortunately failed to realise the high hopes entertained of it.

V. England

Not to speak of other countries, England herself, the impregnable stronghold of *laissez-faire*, was not able to keep herself aloof from the current tendencies. The promotion of manufacturing industry by direct financial assistance had been no part of her policy. But in the post-war years she broke away from the traditions of the past and in several instances furnished direct financial assistance to British industry.

One of the most notable instances in which the British Government rendered direct financial assistance was in the case of the "Dye Stuffs" industry. According to the recommendations of a Committee appointed by the Board of Trade in 1916 that financial assistance should be given to the Dye Manufacturers either by way of subsidy or by way of loan, Parliament voted in 1918 the sum of £2,000,000 "for the development of the Dye Industry by means of financial assistance in aid of developments, extensions and research."[1] When the British Dyes, Ltd., was formed in 1915 the Government undertook to subscribe £1 for every £1 of capital subscribed outside up to £1,000,000 and £1 for every £4 of capital subscribed outside over £1,000,000. The Government could nominate two Directors out of a total of 6 to 12. In 1919 the British Dye Stuffs Corporation was formed as a result of a fusion between the British Dyes, Ltd., and Messrs. Levinstein with a capital of £6 millions which was raised to £10 millions. The Government holding became £1,700,000 composed of 850,000 preferred ordinary shares fully paid and 850,001 preference shares fully paid.[2]

[1] *Report of the Committee on Industry and Trade—Factors in Industrial and Commercial Efficiency*, 1927.

[2] Government Investments in Registered Companies, No. 250. 1921.

The Corporation was further aided by the absolute prohibition for 10 years of the import of dye stuffs except under license and by a Government subsidy of £100,000 towards research. It paid a dividend of 8% in 1920. The scheme came to an end in 1922.

The Government of the day assisted the Munster Flax Development Company by taking debentures to the extent of £33,000 in respect of flax growing by the company. A Government guarantee was also given on similar lines. This company, however, went into voluntary liquidation in December, 1925, and only £1,375 out of the total amount subscribed was recovered by the Government.[1]

Perhaps the most important measure of state financial assistance accorded to an industry in England has been in the case of the Beet Sugar Industry. Ever since the beginning of the twentieth century, endeavours have been made to secure state-aid for the industry without which its successful commercial development was not believed to be possible. The prospect of the British Sugar Beet Society to acquire a large estate for the purpose of building a Sugar Beet Factory and of growing beet in sufficient quantities for its operation was considered by the Selborne Committee. In their Report in 1917 the Committee recommended the making of an experiment on a commercial scale with state assistance. Money was accordingly advanced from the Development Fund for the purchase of the Kelham Estate in Nottinghamshire, but the provision for further state assistance necessary to erect the factory was not made till 1919. It was decided to grant capital assistance for the erection of a factory in that year. In February, 1920, the Home Grown Sugar Ltd. was formed with a capital of £500,000 to develop the beet sugar industry. It acquired the Kelham estate and proceeded to build the Kelham factory. The Government undertook to subscribe for a number of ordinary shares of £1 each (not

[1] Report of the Committee on Industry and Trade—Factors in Industrial and Commercial Efficiency, 1927, p. 387.

exceeding 250,000) equivalent to the number allotted to the public subscribers. The Government further guaranteed interest at 5% on the shares allotted to public subscribers for 10 years and undertook not to take any interest on its own shareholdings till the public subscribers had received 5% on their shares.[1] The object of Government guarantee was to subsidize the industry during the earlier years as a profitable commercial proposition by ensuring a sure dividend to the public. Ultimately, however, the company would be encouraged to divest itself of Government control and assistance. Owing to the high prices of building machinery, a further sum of £200,000 had to be raised. £75,000 had to be raised on a first mortgage on the property and £125,000 was lent by the Government at 7% on a second mortgage, the loan being repayable in 1930. The British Government Treasury subsequently guaranteed the debentures of several sugar beet companies. The following financial statement gives the details [2] :—

Guaranteed by H. M. Treasury

Name of Company.	Debentures and other permanent loan capital outstanding.
1. Anglo-Scottish Beet Sugar Corporation Ltd., 1924.	£511,500 (including £140,000 of 5% convertible notes. The balance of £469,500 is guaranteed by H. M. Treasury).
2. West Midland Sugar Co., Ltd. (1925).	£34,200.
3. Second Anglo-Scottish Beet Sugar Corporation (1926).	£741,400.
4. Lincolnshire Sugar Co., Ltd. (1927).	£31,800.

A scheme of direct assistance by means of a subsidy to home produced beet sugar was announced by the Chancellor of the

[1] A. Y. Campbell—Report on the State-Aid to Industries in the British Empire, France, Germany, the United States and Japan, 1923, p. 53.

[2] Report of the United Kingdom Sugar Inquiry Committee, 1935, cmd. 4871, Table XXI.

Exchequer in his speech on 30th July, 1924. The Chancellor observed that the beet sugar industry had been developed nowhere except with state assistance. A period of ten years was necessary during which state-aid was required to enable the industry to get upon its feet and develop sufficiently to stand alone; and a subsidy on a diminishing scale for a period of 10 years would be exactly suited to the requirements of the industry. In the next year, the British Sugar (Subsidy) Act, 1925, was passed, providing for a subsidy at the rate of 19*s*. 6*d*. per cwt. until 1928, afterwards 13*s*. per cwt. for 3 years, and then 6*s*. 6*d*. for a further period of 3 years. The subsidy was extended for an extra year under the British Sugar (Subsidy) Act of 1934.[1]

The assistance has been successful in producing a considerable development of beet sugar production in the United Kingdom. There were only two factories in 1924 and a third was in the process of construction. Since then sixteen more factories have been built. Altogether eighteen factories were in operation in 1935, one having ceased production. The total amount of subsidy paid up to 1933-34 was £30,112,077.[2] The sugar industry was given state-aid in order that an experiment might be made of growing sugar beet on a commercial scale The Government at that time believed that the assistance would be definitely temporary and its need would disappear ultimately. But subsequent developments, *e.g.*, the catastrophic fall in sugar prices, clearly indicate that sugar beet cannot be grown at existing sugar prices without state-aid.

The continuance of the policy of state-aid has, therefore, been urged in many quarters. The recent Sugar Inquiry Committee, however, found that the need of state assistance was permanent and that strong grounds of public advantage justifying such permanent aid were lacking. The majority report was unable

[1] Report of the United Kingdom Sugar Industry Inquiry Committee, 1935, cmd. 4871, pp. 19-21.

[2] *Ibid*, Table XX, p. 34.

to recommend the continuance of state assistance and characterised it in the case of the Beet Sugar Industry as a "haphazard, extravagant and inequitable method of relief."[1] The direct and indirect cost to the State of continuing the assistance in 1934-35 was expected to be £7,300,000. The advantages obtained in return were quite inadequate and were not so real as supposed. They found "no positive justification for the expenditure of a sum of several million pounds per annum on an industry which has no reasonable prospects of ever becoming self-supporting."[2] The minority report was in favour of the continuance of the subsidy. The Government, however, decided to continue the subsidy indefinitely on "agricultural grounds." Early in 1936 a measure was introduced into Parliament for the reorganisation of the sugar industry. Under it the subsidy was to be payable to the British Sugar Corporation, a semi-public utility undertaking to be formed for the purpose of amalgamating the existing beet sugar manufacturing companies. The Treasury would guarantee its debenture issue to enable it to secure working capital.[3] The Corporation, amalgamating 15 sugar companies, was subsequently created with a capital of £5,000,000, distributed among the various companies in exchange for their share capitals. An issue of £750,000 2¾% debenture stock guaranteed by the Treasury was made to the 15 vendor companies to provide working capital.[4]

There is an instance of financial assistance by the British Government even before the Great War, although that was for naval purposes. So early as 1903, in terms of Admiralty Contract with the Cunard Steamship Company, a loan of £2,600,000 was advanced to be repaid in 20 years, the rate of interest being 2¾%. The fleet of the company and its other property were pledged to the Government as security for the loan.[5] In more recent times

1 Report of the United Kingdom Sugar Industry Inquiry Committee, 1935, p. 98.

2 *Ibid*, pp. 99 102.

3 *The Statist*, February 8, 1936, pp. 220-21.

4 *The Economist*, August 29, 1936, pp. 403-04.

5 Government Aid to Merchant Shipping, pp. 22, 51, 54, 55. Copy of Agreement with the Cunard Steamship Co., 1903.

the British Government undertook to provide financial facilities for the completion of the giant Cunard liner "Queen Mary" then known as "No. 534."

It is interesting to note in this connection that the ship-building industry has received, during the recent depression, very substantial assistance from the Governments of several other countries. In the years immediately following the Great War, ambitious schemes for the construction of merchant ships were drawn up by almost all nations of the world. This activity received much encouragement from the post-war boom in international trade. When this short-lived boom was followed by a slump and even yet afterwards when the financial storm broke on the world, their activities went on unchecked. The result was that large numbers of ships had to remain in idleness. The problem was solved in the different countries by the respective Governments calling upon the tax-payers to bear the losses incurred in operating the vessels. The most extensive form of state-aid for shipping was given by the United States Government. The Jones White Act provided a ship-building fund of 250 million dollars to be lent at a low rate of interest so as to encourage the building of mail-carrying ships. The loans would be for a period of 20 years. In addition Congress authorised the Postmaster-General to grant subsidies on a scale more generous than that adopted by any other country. American ship-owners are not satisfied even with this large measure of state-aid and are agitating for its further extension so that the construction of sea-going cargo ships may be encouraged.[1]

VI. *Japan*

The history of state-aid to industry cannot be claimed to have been particularly happy in the Western countries.

[1] "America as a Sea-going Power"—an article by Sir Archibald Hurd, Managing Editor of the *Shipping World*.

Expectations have not been fulfilled; financial results have seldom been satisfactory; and the experiment in several cases had to be abandoned. But although state-aid has not been very successful in the West, there is at least one country in the East where glorious results have been achieved. There is perhaps no country in the world, where a more active policy of State-Aid to industry has been pursued than in Japan; and there is no country in the world where state-aid has produced such a rich harvest of results. It is difficult to account for the complete success of the policy of State-Aid in an Eastern country whilst it has been a comparative failure in the West. Important psychological factors are probably at the root of the matter. Peculiar Eastern traditions, the people's lack of initiative, their extreme dependence upon the Government in every sphere of life, their habit of looking up to the Government for the solution of every difficulty—all these must have favoured the success of the policy of State-Aid in an Eastern country like Japan. The country to-day ranks amongst the foremost industrial nations of the world. Within a surprisingly brief period she has turned herself from a backward agricultural country into one of the most industrially advanced in the world. This amazing industrial progress of the country has, to a considerable extent, been due to the active policy of State-Aid followed by the Japanese Government. Whatever might be the part played by other factors, it must be frankly recognized that it is the active Government participation which has made possible the greater part of Japan's industrial progress. From the earliest times the Government has taken an active part in the industrialization of the country. The Government had to take the lead; it could not do otherwise. The supply of capital was hopelessly inadequate for the new forms of production and for the material equipment of the country. The merchant and industrial classes were incapable of the great task before them. Hence the Government stepped in to take upon itself the task of shaping and initiating the industrial advance of the country.

"It decided itself what enterprises should be inaugurated, it established itself or furnished the capital for their establishment by private companies ; it encouraged technical and scientific training, it imported instructors from abroad." [1] The Government has maintained that initiative even to the present day. It has not been able to withdraw from industry and is continuing to introduce and support new industries and assist old ones in difficulties. It has extended its aid to the national industries very liberally and in various ways. Besides assisting industry indirectly by controlling tariffs, etc., it has actively assisted it directly by granting loans and subsidies. Not only infant but also old and well-established industries have received Government help in this manner. Advances are made to the industries, either direct or through banks. As will be seen in a later chapter the Government has from time to time advanced considerable sums to the Industrial Bank for assisting industries in need of finance. As early as 1898 the Government placed 5 million yen at the disposal of the Hypothec Bank for the purpose of making loans to industrial undertakings. In 1913 the Government advanced to the Industrial Bank 13,500,000 yen through the Bank of Japan and the Yokohama Specie Bank. Besides the loans, private enterprises are often protected by guaranteeing profits. Small industries are also not neglected. The annual budget regularly includes items for the encouragement of small industries.[2] Since 1928, the Government has made to them repeated advances at low interest through special banks or through provincial public bodies.[3]

Coming to specific industries we find that the shipbuilding industry is one of the most important industries to receive Government assistance from early time of the modern period. The policy of subsidizing followed under the provisions of the

[1] John and Dorothy Orchard, *The New Economic Position of Japan* (1930), p. 79.

[2] Report of the Committee of Industry and Trade—Survey of the Overseas Market, p. 409.

[3] *Japanese Trade and Industry, Present and Future* (Mitsubishi Economic Research Bureau), p. 427.

Shipbuilding Encouragement Act of 1896 and the Navigation Encouragement Amendment Act of 1899 has been to a great extent responsible for the rapid development of that industry. Between 1896 and 1918 the subsidy paid by the Government under the Acts amounted to 22,757,495 yen. During that period the total tonnage of Japanese ships increased by 1,300,00 tons, an increase of 57·3% as compared with the year when the latter Act was passed. This rapid increase may not be wholly due to the Act but it is understood that this high record would not have been established without the subsidy.[1] The development of the Japanese Merchant Marine has also been due to the large measure of financial assistance from the State. During 1902 to 1926, a total of 297 millon yen was paid out to various shipping companies in the form of bounties and subsidies.[2] Without the Government assistance Japanese shipping would not have been able to make the progress it has made and could have been operated only at a loss to the owners. In more recent times it was reported that the Japanese Government was considering a scheme, put forward by the Minister of Communications, under which a subsidy amounting to 10 million yen (£1,000,000 at par) to be spread over three years would be paid to shipping firms. The money was to be raised by the issue of bonds. The proposal, if adopted, would result in the granting of a subsidy of £4 per gross ton of 250,000 tons of new shipping on the condition that 500,000 tons of ships over 35 years old were simultaneously scrapped.

The Iron and Steel Industry also owes its expansion to the liberal assistance of the Government from the very beginning. Without the liberal use of the Government funds in the earlier period and its continued assistance since, Japan could have no iron and steel industry to-day.[3]

1 S. Uyehara, *The Trade and Industry of Japan*, p. 165.

2 Financial and Economic Annual of Japan (1900-28).

3 In 1934 the Japan Iron Manufacturing Co., was formed with the aid of the Government as the result of a vast amalgamation of iron and steel concerns.

As regards the manufacturing industries, it is the same story. The Government pioneered a large number of important enterprises and liberally assisted others. It established the first chemical works, the first arsenal, the first glass factory, the first silk filature. At one time or another the Government has established or operated cotton and wool spinning mills, cement, brick, soap and porcelain works, food factories and so on.[1] In recent years the aircrafts industry has received a large amount of assistance from the State. The Dye Stuff industry has also been liberally subsidized. The Osaka Dye Stuffs industry (establised in 1915), for instance, received up to 1927 a sum of 7,500,000 yen in subsidies and bounties from the Government.[2] Subsidies have also been granted for the development of a number of other "Key" industries, such as manufacture of soda ash, artificial indigo, etc.[3] Indeed it will be no exaggeration to say that modern Japanese industry owes its development mainly to the efforts and encouragement of a highly paternalistic Central Government.

Conclusions

From the survey of the policy of State-Aid pursued in Japan and in the various Native States, it is clear that it may be operated in such a manner as to be not only financially successful but also to promote the industrial development of the country. It is only necessary that a piecemeal haphazard policy should be avoided and a comprehensive, well-balanced and carefully thought-out plan should be adopted in rendering state-aid to industry. There is no reason why such a policy should not be successful in India. It has achieved brilliant results in Japan. The results have been less spectacular in the Native States but none the less they have been in the majority of cases quite satisfactory and the object has been fulfilled. Before rejecting the principle of

[1] John and Dorothy Orchard, *The New Economic Position of Japan* (1930), p. 90.

[2] "Present-Day Japan"—*Asahi, English Supplement*, 1929, pp. 118, 121.

[3] *Japanese Trade and Industry, Present and Future* (Mitsubishi Economic Research Bureau), p. 47.

State-Aid for Indian industries, it should, in our opinion, be given a fair trial once more.

The principle of State-Aid to industry has been finding increasing favour ever since the last Great War. More recently in these days of economic planning, the State in every civilised country of the world has come to dominate trade and industry in a manner which could have never been thought possible a few years ago. The death-knell of *laissez-faire* has already been sounded and there is no chance of its ever being resuscitated. It has been frankly recognised that it would be the height of indiscretion for a country to stand idly by when its industries may be going to the wall on account of the competition of state-aided industries elsewhere. Even England herself, the greatest stronghold of *laissez-faire*, has had to break away from her traditional policy. Under the enormous stress of subsidized foreign competition, British shipping, than which perhaps an industry more entirely independent of official aid, more traditionally self-reliant and self-sufficient in its resources did not exist, has been compelled to ask for financial assistance from the Government, and the Government, realising the gravity of the situation, has approved of a scheme of subsidy for the industry.

While advocating the principle of State-Aid to industry in India, the following theoretical considerations should be urged. State assistance to industry whether financial or otherwise should never be permanent. The guiding principle should always be to furnish the aid temporarily for an experimental period or for maintaining an established industry over a period of stress. The period for which an established industry requires state-aid will vary from industry to industry. Generally speaking, ten years may be taken to be a period sufficient for an industry to develop itself properly and to stand alone without the artificial prop of state assistance. The ultimate withdrawal of the assistance should always be aimed at. Very strong financial and economic grounds are needed to justify a policy of State-Aid for a more or less indefinite period.

It has already been emphasised that instead of rendering financial assistance to Indian industries through the Departments of Industries, State-Aid should be furnished through a Bank. The Industrial Bank of Japan and the various Agricultural and Industrial Banks have been utilized with remarkable success by the Government of Japan in this respect. The inspiration for direct legislation under which State-Aid may be furnished to Indian industry was obtained by the Provincial Governments chiefly from Columbia, Victoria, and South Australia. Laws closely analogous to the State-Aid to Industries Acts in India have been shown to have been prevalent there long before any of the Provincial Governments here contemplated the passing of any such legislation. It is interesting to note that in Victoria and South Australia the administration of the Acts providing for State assistance to industry was handed over to banks after the first few years of experiment. Our argument for granting State-Aid through a banking institution is reinforced by the recent policies of the Governments of these countries.

CHAPTER IX

Specialist Institutions for Industrial Financing—The Industrial Bank of Japan

The question of establishing specialist institutions for providing industrial finance has in recent years received a great deal of attention in several countries. The need of filling the gap in the existing financial machinery by forming a special organisation is being increasingly perceived, and wherever industries have been unable to satisfy their long-term financial needs from the existing sources, the desirability of starting a special institution to cater for such requirements has been recognised. A number of countries in the post-war years have already set up such machineries specially designed to furnish long-term finance to their industries. Several other countries are also contemplating the organisation of specialist institutions for the same purpose. The question of forming special machineries for supplying long-term finance to Indian industries has been before the country for nearly two decades. It has engaged the earnest attention of our economists and publicists ever since the Indian Industrial Commission recommended the establishment of "industrial banks" in 1918. The formation of specialist institutions for solving the problem of industrial finance was also recommended by the External Capital Committee in 1924 and again by the Banking Enquiry Committees, Central and Provincial, in 1930-31. A detailed study of the work which has been done abroad as regards the organisation of industrial credit will at the present moment prove to be not only of absorbing interest but also highly instructive. A review of the basis on which institutions specially designed for financing industries are working elsewhere and of their activities and achievements will undoubtedly be a fruitful line of research. It will

materially assist us in the solution of the problems arising in connection with the organisation of industrial finance in India and will help us to lay down the broad lines which a scheme for the future Indian institution for solving the problem of industrial finance may be formulated.

Again it may be recalled that the history of state-aid to industry in the various provinces of India has been singularly unhappy. The question has, therefore, been frequently canvassed that if any financial assistance is to be rendered to industries by the State, it should be done through a special "industrial bank," and the administration of the State-Aid to Industries Acts should be handed over to such institutions. From the study we are going to make of these specialist institutions working abroad, it will also be possible for us to gather how far their machineries have been successfully utilised by the Governments of those countries for rendering financial assistance to their industries. For all these considerations, a detailed review of the structure, organisation and operations of specialist institutions that have been started elsewhere to solve the problem of industrial finance is urgently called for.

Before we turn to review the working of the specialist institutions established for the provision of industrial finance, it is necessary to dispel some illusions as regards the industrial activities of the German banks. It is commonly believed that the German banks are specialist institutions catering for the long-term financial needs of German industry. This notion is entirely misleading. They were never specifically designed for financing industries. The truth is that at one stage of their evolution they had combined commercial with investment banking business. In the post-war years; as already noted, there has been an increasing tendency on their part to shed their investment banking activities and approximate to the pre-war deposit banks of England. Under the circumstances, it will not be correct to refer to these German banks as specialist institutions devoted to the financing of industries.

The earliest institutions that were ever started with the particular object of industrial financing were the Societe-General de Belgique founded in Belgium in 1822 and the famous Credit Mobilier founded in France in 1852. It was intended that they should devote themselves specially to the development of industry. They were the pioneers in the field of industrial financing, the forerunners of all later industrial banking.

The characteristic activities of the Societe-General consisted in the promotion of new industrial companies, in the establishment of financial subsidiaries to hold the shares of these companies and in also taking up itself considerable amounts of these shares. The necessary funds for the operations were obtained by the Bank from (1) its own paid-up share capital and (2) savings bank deposits as well as (3) by the issue of fixed interest bearing debentures and notes payable on demand. The Bank promoted companies for opening up coal fields and for the construction of railways and canals ; and also formed financial subsidiaries, the chief of which were the "Societe de Commerce Bruxelles" and the "Societe nationale pour enterprises industrielles et commerciales." But the Bank made indiscriminate use of the savings deposits which were never kept separate from other funds and were employed in long-term industrial finance. The relations between the parent Bank and its subsidiaries were very unsatisfactory. "The relation was one of mutual participation and in addition the subsidiaries borrowed extensively from the parent Bank in order to carry unmarketable securities."[1] During the crisis produced in France and elsewhere by the Revolution of 1848, the Bank became seriously involved. An enquiry into its position revealed that a considerable portion of its assets had been locked up in unrealisable security holdings. The remaining assets consisted of loans made against the pledge of such securities with little regard for the personal credit of the

[1] P. B. Whale, "English and Continental Banking," Lecture II—*Journal of the Institute of Bankers*, May, 1931, p. 260.

borrower. A new Board of Management was formed and a reorganisation followed. Since the establishment of the Banque National de Belgique in 1851, the Societe-General came to modify the character of its business. Its investment trust activities were restricted, though the interest in long-term industrial finance was not entirely abandoned ; but increasing attention came to be devoted to ordinary deposit banking business.

As an institution specifically designed for financing industries, the Credit Mobilier of France has aroused much greater interest. Ever since its establishment by the Pereire Brothers in 1852, the institution has engaged the earnest attention of economists and publicists throughout the world. In all discussions regarding the establishment of specialist institutions for providing industrial finance, it has held a prominent place. Indeed, it will perhaps be no exaggeration to say that in the pre-war days, it was the only known model before a country which was desirous of founding an "industrial bank" for the financing of its own industries. As originally designed the Credit Mobilier was to have a share capital of 50 million francs and was also to issue, besides short-term notes, debentures up to 10 times its share capital. The main object of the Bank was to function as a "financing institution which would sell the shares in the undertakings it promoted when they were ripe for the market and thus obtain the means of financing new enterprises." The Bank at first attained notable success and showed large profits. It promoted a large number of railways both in France and abroad as well as insurance companies and foreign subsidiary banks; it founded the Paris Omnibus Company and the first French Transatlantic line; it equipped Paris and other towns of France with gas lighting ; and finally it issued considerable amounts of French and other Government loans.[1]

[1] P. B. Whale, "English and Continental Banking," Lecture II—*Journal of the Institute of Bankers*, May, 1931, p. 262.

But during the crisis of 1857 its affairs became seriously involved and the crash came in 1867 after a brief career of 15 years. A large part of its resources became immobilized in securities quickly depreciating in value. The rest were locked up in advances against such securities and in advances to its dependent companies. The Credit Mobilier was chiefly interested in public utility enterprises which, by their very nature, could not be expected to show immediate returns. The shares of such companies were not readily marketable. The principal holdings of the Credit Mobilier consisting of such unmarketable securities, its resources became hopelessly entangled in such investments. It appears that the original plan of issuing debentures was not put in practice and the funds other than long-term were used for investment purposes. If debentures had been issued, the immobilization would not have had the same disastrous consequences. Besides, it ignored the root principle of industrial financing, namely, that of carefully distributing its risks. It did not proceed with caution and was anxious from the beginning to attain a spectacular success and show large profits. For all these reasons, downfall soon overtook the Bank.

Throughout the nineteenth century, the Credit Mobilier attracted considerable attention. It provided a great appeal to all those countries which were desirous of achieving a rapid industrial progress; and Japan chose it as the model, when she founded her Industrial Bank in 1902 for the purpose of financing her industrial development. Till the close of the last Great War the Japanese institution remained as the only type of a specialist bank, designed primarily for the financing of industries. Not until we come to the post-war years and the more recent years of the world-wide depression, do we find any systematic attempt made in European countries to evolve a new type of machinery for the long-term financing of industries. During the post-war years, industries in several European countries found it exceedingly difficult to satisfy their long-term needs.

These countries had been utterly impoverished by the effects of a war unexampled in history; and there was a shortage of industrial capital as never before. The prolonged slump that followed in the wake of the Great War only served to aggravate the acute financial position of the affected industries. Their long-term needs had to remain unsatisfied or had to be satisfied from short-term funds, a policy which was at once costly and dangerous. Again, in many instances the ravages left behind by the War had to be repaired. Old industries damaged by the War had to be rehabilitated; modernisation of plant and adaptation to post-war requirements were urgently called for in a number of others; and new industries had also to be started and nourished. Never was there a greater demand for long-dated capital for industry; and never was felt a more imperative need for organizing a special machinery to supply that capital. Attempts have accordingly been made in some of the new and reconstructed countries of Central and Eastern Europe to establish suitable machineries to furnish that much-needed long-term capital to their national industries.

Ever since the Landschafts were first organised in Germany, the device of the mortgage bank has been employed with remarkable success to solve the problem of long-term real estate credit. The whole theory of the mortgage bank is based upon the debenture bond, the system of amortisation and the sinking fund. The mortgage bank is a specialist institution granting long-term amortisation loans on the first mortgages of property and issuing bonds to raise the necessary funds for financing these loans. It had its origin in the necessity for providing agricultural credits on reasonable terms; and this type of machinery was in the beginning exclusively employed for granting long-term credit on first mortgages of agricultural property. Its success in that sphere was so great and the advantages for financing long-term loans through such a device were found to be so numerous that it began to be employed for all kinds of real estate credit, not only agricultural

but also urban and communal. Not only organisations founded in order to aid agriculture primarily have begun to devote increasing attention to loans on city real estate, but even municipalities, communal authorities and public bodies in general, have found that the same type of machinery is adaptable for financing their long-term operations; and special communal bonds have frequently been issued to finance such public utility undertakings as gas, electricity and water-works. In the present times the operations of the mortgage institute have come to be extended yet further to the field of industrial credit. During the post-war years, the idea of a mortgage bank, granting long-term amortisation loans against industrial property, made an instant appeal to a number of European countries. Their economic position was shattered by the War; and they were anxious to hasten their economic reconstruction. The difficult task of supplying long-term finance to their industries had to be faced; and necessary funds had to be raised either at home or abroad. The machinery of long-term real estate credit which had so successfully worked in other spheres was readily adopted by them to furnish long-term mortgage loans to industry. Since 1924 several countries in Central and Eastern Europe have established industrial mortgage banks, especially designed for financing industries. These institutions, like their *confrères* the land mortgage banks, are issuing mortgage bonds and granting long-term loans to industrial undertakings on first mortgages of industrial real property, factories, buildings, machinery, plant, etc. Like them, these industrial banks have been organised both on the joint-stock and co-operative basis. Like them, too, they have frequently been started under Government auspices and as a rule enjoy some form of State-Aid. Wherever there is such State-Aid, there is some corresponding governmental control or supervision. The needs of the small and middle-sized industries receive primary attention from these institutions, as it has always been difficult for them to approach the market. But the large industries are not neglected and

receive also their due share of attention. The largest of these industrial mortgage banks, whose bonds have been well received and are quoted in the stock exchanges of New York, Boston and London, are the Industrial Mortgage Bank of Finland, Ltd., the National Hungarian Industrial Mortgage Institute Ltd., and the Sächsische Landespfandbriefanstalt (the Provincial Mortgage Bank of Saxony). Besides these three, there is another mortgage institute, the National Economic Bank of Poland, which was founded in 1924, by virtue of a special law to assist the economic reconstruction of the new state of Poland. It grants long-term industrial loans through the issue of "bank debentures" but it should be put in a separate class by itself as distinct from the other three institutions. It is not a mortgage bank specifically designed for financing industries alone; its activities are not restricted to the granting of industrial credit only, not even to that of long-term credit. Its activities comprise the granting of both short and long-term credit, not only to industries, State and private, but also to municipalities, rural district authorities and owners of agricultural estates. Different types of bonds—"communal," "bank," etc.—are issued to finance the varied operations of the institute. Besides fulfilling all these functions, it conducts every description of banking business. In other words, it is not a special but a mixed mortgage bank.

In the more recent years of the world-wide depression, when industries were passing through extremely difficult periods, attempts were made by several other countries to set up special machineries for supplying long and medium-term finance to these industries. An outstanding example of such an attempt has found expression, as already noted, in the British "Credit for Industry, Ltd." In Ireland also an "Industrial Credit Co., Ltd." has recently been established for the purpose of financing Irish industry. More recently even Sweden, where ordinary banks have always had an industrial bias, is contemplating to set up a specialist institution for providing long and medium-term finance to Swedish industry.

The Industrial Bank of Japan [1]

The most important institutional development of industrial finance since the establishment of the French Credit Mobilier took place in Japan when the Industrial Bank of Japan was founded in 1902. It was an ambitious experiment in investment banking conceived more or less on the lines of the French institution. Until recently it has been the only instance of a specialist institution established primarily for the financing of industries ; and as such has attracted considerable notice not only in European countries but even in India. It made a profound appeal to the Indian Industrial Commission of 1916 who were mainly responsible for popularising the idea of forming an "industrial bank" in India on the model of the Japanese institution. It has since that time been strongly favoured by Indian economists and publicists. The idea of planning the future Indian institution on the lines of the Japanese bank which originated with the Industrial Commission was re-born in the deliberations of the Indian Central Banking Enquiry Committee. Indeed in all discussions regarding the establishment of specialised banks in India for industrial financing, the Japanese institution has always occupied the centre of the stage. But although so much interest has been focussed upon it for all these years, no attempt appears to have been made in this country to make a detailed study of the nature, organisation and activities of this much talked about institution. Information regarding the Bank has been either entirely lacking or has been extremely meagre. Consequently a great deal of misconception as to its true nature and functions has unfortunately crept into India. Even the "Foreign experts" who were invited to assist the deliberations

1 The materials were obtained from the authorities of the Industrial Bank of Japan with the assistance of His Britannic Majesty's Consul in Tokyo. Much useful information was secured from Mr. Hara, Consul for Japan in Calcutta, President of the Indo-Japanese Commercial Museum, the Yokohama Specie Bank and the Mitsui Bank.

The substance was published in the form of an article in the *Calcutta Review*, May and June, 1932. (Revised and re-written.)

of the Indian Central Banking Enquiry Committee were not free from these misapprehensions. The exposition of the working of the Japanese institution which they gave to the members of the Banking Committee was in some important respects incorrect and misleading. It is certainly worth our while to attempt a detailed investigation into the working of an institution which has aroused so much interest not only in India but throughout the world and for which information has been hitherto singularly lacking.

The national banks were established in Japan in 1873 in pursuance of the National Bank Regulations of 1872 which were closely patterned after the American system. A law passed in 1896 provided for the abolition of these national banks; and between 1896 and 1899 the 153 national banks scattered in various important cities were abolished and reorganised as ordinary banks. At the same time numerous ordinary banks were newly opened throughout the country. Though these were commercial in form and denomination, most of them were particularly agricultural organs and were engaged in advancing money to the farmers on mortgages consisting of immovable property.

Prince Matsukata is the father of the present Japanese banking system. He enunciated the principle that distinct groups of banks should be established to fulfil different functions. Accordingly, after founding a central bank and an exchange bank, he turned his attention to the starting of banking institutions to facilitate the grant of long-term loans to industry and agriculture. The industrial development of the country had not proceeded very far by the time of the Sino-Japanese War. But the victory over the Chinese gave a powerful stimulus to the economic life of the country. New enterprises came rapidly into existence and there arose on the part of their projectors a great demand for long-term financial assistance. It was beyond the province of the ordinary deposit banks to render such assistance. There was also at the time no large investing public in Japan.

The conservative people were reluctant to invest their savings in industry and preferred to invest in land even though the rate of return might be lower in the latter. To satisfy this new demand for long-term industrial capital, the Industrial Bank was established.

The Government enacted the law of the Japan Industrial Bank in 1900 and the Bank began business in April, 1902. It is a jointstock company and its capital was at first 10 million yen. By a revision in the law of the Industrial Bank in 1906, the capital was raised to 17,500,000 yen, which could be increased with the approval of the Government.[1] The capital was subsequently increased to 30,000,000 yen in 1917 and again to 50,000,000 yen in 1919. The capital was fully paid in 1922.[2] The Government of Japan does not participate in the capital of the Bank but it lends to the Bank enormous funds at a moderate rate of interest out of the resources of the Deposits Bureau of the Department of Finance. The deposits of the Bureau consist mostly of the postal savings deposits received by the Government. Its business is not merely confined to the control of deposits but also includes the investment and management of funds. It has been laid down by the law that the funds of the Bureau should be invested solely for the benefit of the State and the public in a safe and profitable manner and that such investments are to be made only after investigation of their purposes and methods in connection with the committee of investments of the Deposits Bureau.[3] There is one peculiar characteristic of the Industrial Bank which distinguishes it from the other public institutions. Early in the history of the Industrial Bank, a considerable portion of its shares came to be held by foreigners.[4] According

1 Art. 2, Law of Incorporation of the Nippon Kogyo Ginko, 1900.

2 The shares of the Industrial Bank have a par value of 50 yen. Prices have been declining since 1922. From 1918 to 1927 they ranged from 94 yen to 60·40 yen. The Imperial Household Department held 22,725 shares in 1929.

3 Thirty-fourth Financial and Economic Annual of Japan, pp. 200-03.

4 See Report of the National Monetary Commission, 1910—Banking System of Japan, pp. 137 and pp. 156-57.

to the *Japan Year Book*, 1924-25, foreigners owned 75,000,000 yen of the Bank's capital.[1]

The Bank was established with a Government subsidy under Government control with a 50-year charter, the renewal of the charter being at the option of the Government. It was put under the direct superintendence of the Finance Minister who was to appoint a Comptroller to supervise the business management of the Bank. The President and the Vice-President are appointed by the Government from among shareholders owning more than 200 shares in the Bank. Their term of office is fixed at five years. The directors are appointed by the Government from among the candidates who hold more than 100 shares in the Bank, elected at the General meeting of the shareholders. The number of candidates which the meeting recommends is twice the number of necessary directors. Their tenure of office is fixed at three years.[2] As regards the subsidy, the Government undertook to guarantee a 5% return on the Bank's shares for the first five years, provided the amount of the subsidy did not exceed 5% of the paid-up capital.[3] The business of the Industrial Bank is as follows :—

(1) To make loans on the security of national bonds, prefectural or municipal loan bonds or debentures and shares of companies.

(2) To subscribe for and underwrite national loan bonds, prefectural and municipal loan bonds or debentures of companies.

(3) To receive deposits of money on fixed, current or special account and undertake the custody of goods entrusted to it for safe keeping.

(4) To undertake trust business relating to secured debentures.

[1] *The Japan Year Book*, 1924-25, p. 455.

[2] Art. 7, Law of Incorporation of Nippon Kogyo Ginko, 1900.

[3] Art. 26, *ibid.*

(5) To discount bills.

(6) To buy and sell clean and documentary bills of exchange.

(7) To make loans on mortgage or estates created by virtue of special laws. (Added March, 1905)

(8) To make loans on mortgages of land and buildings belonging to factories. (Added by Law No. 6, March 14, 1933.)

(9) To make loans on mortgages of ships including those under construction which shall be redeemable by annual instalments within a period not exceeding 15 years or a fixed term of not more than 5 years.[1] (Added by Law No. 26, March, 1918.)

(10) To make loans on the security of shipbuilding materials or equipments. (Added by Law No. 26, March, 1918.)

(11) To float National loan bonds, prefectural and municipal bonds and companies' shares and debentures and to receive payments for the same and to effect the payment of principal and interests, or dividends on the above.

(12) To make call loans or loans for a fixed term on security of sites and buildings belonging to factories or of residential land or buildings lying in localities where the City Planning Act is in force, provided that the total amount of such loans shall not exceed 2/3rd the amount of the Bank's paid-up capital.

In addition to the kinds of business authorised by the above clauses the Bank may subscribe for and underwrite shares of companies with the sanction of the Minister of State for

1 According to Bye-Law Art. 39, ships accepted by the Bank as subjects of mortgages shall be only those which, reckoning from the date of launching, will be less than 25 years old at the date of payment of the last instalment of redemption and shall be covered by insurance.

Finance. Debentures of companies, it may be noted, may be taken up in ordinary course but the subscription to their share capital requires the sanction of the Minister of Finance. The mortgages accepted by the Bank shall be first mortgages, but this does not apply, if they may be converted into first mortgages in course of redeeming an old loan with a new loan furnished by the Bank or if additional mortgages are furnished to the Bank.

To raise funds for the various operations enumerated above, the Industrial Bank was empowered to issue debentures not exceeding ten times its paid-up capital. Such debentures including external and internal, it has been laid down, should not exceed the aggregate of the outstanding bank loans, discounted bills, national, municipal and prefectural loan bonds, debentures and shares of companies owned and the gold and silver held by the Bank.[1] The long-term debentures are redeemable by lot within 30 years reckoning from the year of issue.[2] Besides these long-term bank debentures, discount debentures may also be issued which are to be redeemed within one year.[3]

The money required for making advances to the various industrial companies is raised chiefly by issuing these long-term bank debentures and discount debentures redeemable within one year. The money is sometimes obtained from other sources, as by borrowing from the market in long-term and short-term loans. In 1932, 30 million yen was borrowed in this way.[4] The Treasury Deposits Bureau, as already noted, also furnishes money to the Industrial Bank at moderate rates of interest and sometimes underwrites its debenture issues. For instance, an issue of 6,332,000 yen and of 6,184,000 yen was underwritten by the Bureau in 1932.[5] The money thus obtained is appro-

[1] Art. 12, Law of Incorporation. [2] Art. 15, Law of Incorporation.

[3] Arts. 45-48, Bye-Laws of Nippon Kogyo Ginko.

[4] Sixty-first Report of the Industrial Bank of Japan, for the half-year ending June 30, 1932.

[5] Sixty-first and Sixty-second Reports of the Industrial Bank of Japan, for the half-years ending June 30, 1932 and December 31, 1932.

priated by the Bank for the purpose of loans to industries and for converting bank debentures.[1]

The Bank issues its own debentures both at home and abroad. As regards its bonds floated in foreign countries the Government guarantees the capital redemption and interest payment, whenever the occasion requires such a step.[2] It is evident that the Bank was designed to introduce foreign capital into the country. Its first external loan was a debenture issue, secured by the Japanese Government, of £2,000,000 (19,526,000 yen) floated in England and France in 1908 at 5% rate of interest.[3] During the first eleven years of the Bank's existence as much as 350 million yen was raised abroad for financing Japanese enterprises.[4] This sum included :—

50 million yen raised for Government.

140 ,, ,, ,, ,, Municipalities for public works.

135 ,, ,, ,, ,, South Manchurian Railway.

The sterling debentures of the South Manchurian Railway were issued in London in 1907, 1908 and 1911.[5] As further instances of loan issues in foreign markets, the issues of a £6,000,000 loan in London for the City of Tokyo and of a $19,740,00 loan in New York for the City of Yokohama in 1926 may be mentioned.[6] The Bank signed these contracts as agents of the two cities and completed the proceedings accompanying these issues. The total amount of external debentures issued

1 Sixty-first Report of the Industrial Bank of Japan, June 30, 1932.

2 Source : The Consul of Japan.

3 *Thirty-ninth Annual Table of Bonds and Debentures in Japan* (existing on 31st December, 1932) compiled by the Industrial Bank of Japan furnished by the authorities of the Bank.

4 G. C. Allen, *Modern Japan and its Problems*, p. 166.

5 Financial and Economic Annual of Japan, 1928, pp. 50-51.

6 *Financial and Economic Monthly*, February, 1927, p. 19. Also Fiftieth Report of the Bank, p. 6.

by the Bank still outstanding was 10,107,633 yen in 1932.[1] The issue of own debentures of the Industrial Bank has been increasing from towards the close of the last Great War. The peak was reached in 1923, the year of the Earthquake. The enormous funds thus obtained by the Bank were utilised in restoring the vast areas devastated by the earthquake. Once again during 1931-32 a high point was reached when the Bank, taking advantage of the continuous and pronounced monetary ease, tried to augment the supply of long-term funds by issuing debentures.[2] The bulk of the new issues was intended to replace older issues bearing a higher rate of interest or maturing over a shorter period than was desirable. But by the end of the half year in June 30, 1933, the total amount of outstanding debentures was reduced to a great extent by the liquidation of credits granted to business enterprises. The co-operation of banks and other financial institutions had enabled these undertakings to consolidate their position by public issues and other operations. The Bank has since remained keenly alive to the reorganisation of the debt structure among the industrial and farming communities. The demands upon it or its own debtors are being considerably reduced by conversions and other operations carried out under its own direction.[3]

It may be mentioned in this connection that the Industrial Bank not only played in the earlier years of its inception an important part in the introduction of foreign capital into the country, but in the more recent years has also been instrumental in investing Japanese capital abroad, especially in China. The Government encouraged this policy of the Bank by guaranteeing its profits on foreign investments within a limit of 100 million yen. The Bank has also been the medium through which the

[1] Thirty-fourth Financial and Economic Annual of Japan, 1934, p. 101. The External debentures outstanding (in millions of yen): 1923—10, 1924—54, 1925—54, 1926—54, 1927—10.

[2] Sixty-second Report of the Industrial Bank of Japan, December 31, 1932.

[3] *The Statist*, November 17, 1934, International Banking Section, p. 1757.

Deposits Bureau lent enormous sums to several Chinese enterprises. For example, 7,500,000 yen were advanced to the Nanjin Railway, 9,600,000 yen to the Toa Industrial Company, 2,051,000 yen to Han Yea Ping Company, etc., such investments of the Deposits Bureau through the Bank totalling 128,000,000 yen.[1] In association with the Bank of Taiwan, the Bank of Chosen and other Japanese banks, the Industrial Bank participated in numerous loans to Chinese Governments and enterprises. Between June and September, 1918, the Bank advanced a 10 million yen loan to Kirin Hueing Railway, a 30 million yen mine and forestry loan and another loan to the Kaomi-Hsuchow Shuntefu Tsinantu Railway. Several million yen have also been advanced to the following development companies formed to finance Sino-Japanese industrial enterprises in China, *viz.*, the Toa Kogyo Kabushiki Kaisha, the Chunicho Jitsugyo Kabushiki Kaisha and Nika Boshaku Kabushiki Kaisha. The Bank, in addition, participated in the famous "Nishihara" and other loans to the Chinese Governments.

This policy of foreign investments pursued by the Industrial Bank since the Great War is somewhat similar to the participation of the German Banks in loans to foreign Governments and enterprises. But in the case of the Japanese Bank, there is nowhere to be found the success achieved by the German Banks nor their insistence for a *quid pro quo* for the interests of their associated industrial companies at home. A considerable portion of the Bank's loans to Chinese Governments and enterprises has become "frozen" and unrealisable.

From the foregoing enumeration of the kinds of business the Industrial Bank has been authorised to transact, it is abundantly clear that the institution combines principally the functions of an issue-house with those of a mortgage bank. Although the Bank has been claimed to be essentially a monetary institu-

[1] Herbert Bratter, *Japanese Banking*, p. 182, p. 223.

tion for industry, it cannot be characterised as a pure industrial banking corporation in the sense that it is interested exclusively in industrial issue or mortgage business. For, in addition to its industrial business it frequently floats and underwrites Government and Municipal loan bonds. It does not even stop there but also engages in commercial banking business, such as the discounting of bills and the receiving of deposits.

There is considerable misunderstanding as regards the conduct of ordinary banking business by the Industrial Bank of Japan. The "Foreign Experts" who were invited to assist the Central Banking Enquiry Committee in India believed that the Japanese Bank did not receive deposits or carry on any ordinary banking business, and during the discussions with the members of the Committee strongly made this point.[1] But the Bank is not only expressly authorised by statute to receive deposits and do ordinary banking business but in practice it actually engages in such business in addition to industrial financing. A reference to the various balance-sheets of the institution published semi-annually shows that it accepts fixed, current account and special current deposits. The amount of such business is not insignificant and totalled, at the end of June 30, 1933, 24,273,147 yen, 3,639,695 yen and 11,335,419 yen respectively. Besides these there were special deposits and deposits at notice amounting to 19,200,915 yen and 5,682,012 yen respectively. These various kinds of deposits ran to 64,131,190 yen in a total of liabilities amounting to 578,485,796 yen. On the assets side of the balance-sheet, we find that the Bank discounted bills amounting to 100,634,622 yen and made call loans amounting to 7,700,000 yen. Thus the impression that the Bank does no ordinary banking business is not correct. It is a mixed banking institution with a preponderance of issue and mortgage business.

As a mortgage bank for industry, it is no doubt empowered to furnish loans on the security of real estate, land and factory

[1] Discussions with Foreign Experts—Indian Central Banking Enquiry Committee, Vol. IV, p. 195, p. 197, p. 270.

buildings, but an important part of its business is to supply money on movables, such as making loans on the security of local and national bonds, shares and debentures of companies.[1] The loans it makes to industry are stated to be long-term. But according to Article 40 of the Bye-Laws, loans made by the Bank cannot run for a longer period than five years. Now loans for so short a period as five years can hardly be regarded as long-term. Wherever specialist institutions are catering for the long-term financial needs of industry, the advances are made for a period much longer than five years. They generally run for periods over ten years and frequently for as long as twenty years. Loans running from two to ten years are considered as medium-term. Nowhere does a specialist institution designed for the long-term financing of industries has restricted the period of its long-term loans to five years only.

Under the circumstances the Japanese Bank cannot be said to provide long-term industrial finance. Its loans are at best medium-term. It is only in the case of ship mortgage loans that the period is really long-term. Even here in actual practice loans have frequently been made for periods less than fifteen years. A distinct characteristic of mortgage banks dealing with long-term credit is the provision of amortisation for the loans granted. In the Japanese Industrial Bank, which claims to be an institution engaged in such type of business, it is remarkable that there is no statutory provision for amortisation as regards its industrial loans generally. It is only in the case of the loans against the mortgage of ships that it has been provided that the loans may be redeemable by annual instalments. It will be seen that the Bank has no resemblance to the post-war institutions in European countries which have been specially designed to grant long-term amortisation loans on mortgage of industrial property.

1 Count Okuma, *Fifty Years of New Japan*, p. 527. Also Marquis Katsura, *The Banking System of Japan* (National Monetary Commission).

Although the Bank was authorised to furnish loans on mortgages of other real estate, yet those on the mortgage of ships and shipbuilding appurtenances were given the greatest predominance. There was no other kind of business transacted by the Bank for which such detailed and elaborate regulations were laid down. It was only in the case of such loans that provisions were expressly made in the Law of Incorporation and Bye-Laws as to what proportion of the appraised value of the mortgaged property could be made as a loan. It was laid down, for instance, that the amount of the loan to be advanced on mortgages of ships launched or under construction should be less than two-thirds of their value as estimated by the Bank and less than four-fifths of the insured amount as well, provided that such amount did not exceed the estimated construction value reduced by 4/100th per annum after launching.[1] Ships offered and accepted as mortgage must not be more than 25 years old at the date of the payment of last instalment for the redemption. They must be covered by insurance in a company approved by the Bank. The marine mortgage business of the Bank overshadowed in the past every other kind of mortgage business it engaged in. It is only in recent years, specially after the prolonged slump in the shipping industries, that it has considerably developed its mortgage business as regards general industry, large and small. In the beginning, as a mortgage institute, it functioned primarily as a ship mortgage bank.

Applications for loans from industrial companies are subjected to very close and stringent investigations by the special technical department of the Bank.[2] Loans are granted only on the advice of that department. In assisting industries, the applications were, in the earlier years, judged not so much on the merits of the security offered but by the potentialities of the industry in question and the business reports of the applying company. During the panic of 1927, however, the

[1] Art. 39 (5).

[2] Source: The Consul of Japan.

Bank found that it had to make readjustments in connection with large amounts of its advances and had to take over land and buildings worth half in value of what it had actually loaned. Since that time the Bank has considerably revised its loan policy. More attention is now directed to security values. Special interest is taken in those industries that are found after a close examination to have the prospects of maintenance or development. Loans have been made as promptly as possible and in recent years the Bank has adopted the policy of proceeding in the future with less red tape and more expedition in the financing of industries.[1]

In the beginning the Industrial Bank was chiefly interested in the heavy industries. The shipping, iron and steel, engineering and chemical industries used to receive long-term advances from the Bank.[2] The cotton industry, it will be noticed, is absent from this list and the remarkable progress of that industry owes nothing to the assistance from the Bank. The industry is controlled by powerful firms whose extraordinary financial strength renders them absolutely independent of the Government banks.[3] The Bank's association with the shipbuilding industry of the country has been particularly close. The Kawasaki Shipbuilding Company, the Kokusai Steamship Company and other concerns received considerable amounts of financial assistance from the Bank. It has not only made direct advances to the shipbuilding industry itself but has also been used by the Government as a medium through which State assistance to the industry has been liberally given. During the Great War, when the shipbuilding industry was on the highest wave of prosperity, the Bank, along with the ordinary banks, invested heavily in the industry. But during the slump that followed

1 Sixtieth Report of the *Industrial Bank of Japan*, for the half-year ending December 31, 1931.

2 G. C. Allen, *Modern Japan and its Problems*, p. 165.

3 The Industrial Bank has, however, acted as Trustees of mortgage debentures of the following Spinning and Weaving Companies: (1) Kurashiki Spinning Co. (5 million yen), (2) Toyama Spinning Co. (2 million yen), (3) Kurashiki Silk Weaving Co. (4 million yen).

in the wake of the boom, a large portion of the Bank's advances on security of ships became unrealizable, many shipping companies being unable to pay interest on their loans. Hence the Bank was compelled to discontinue its policy of making advances to shipping companies for several years. It was only in 1929 that the Bank was reported to resume this activity when a sum of 2,800,000 yen was advanced on the security of seven medium-sized vessels. The advances were for less than 15 years and bore interest at 8%.[1] Even when the Bank resumed its ship mortgage business, it decided, owing to the prevailing conditions in the shipping world, to restrict its advances to those who had been engaged in the industry for many years and had proper connections at the principal ports of the world.[2] Ever since the prolonged post-war slump in the shipping industry the marine mortgage business of the Bank has ceased to be so important a line as before. In recent years the Bank has been taking a great deal of interest in its long-term loans business with respect to other industries and as a result its mortgage loans business has tended to grow. Long-term loans to industry have been rapidly increasing since 1926, the peak being reached in 1931. The decline of long-term loans since 1932 is, as we shall see later on, ascribable to a great extent to the fact that industrial concerns had repaid a considerable portion of their dues and that the liberal assistance from the Bank had put them on such a sound footing as to do away with the necessity of further loans.

The following table strikingly illustrates the rapid growth of the fixed loans business of the Bank in recent years [3] :—

At the end of the half-year		Fixed Loans. Yen.
December 31, 1926	...	193,332,760
June 30, 1927	...	201,763,291

[1] *Japan Advertiser*, May, 1929.

[2] Fifty-eighth Report of the Industrial Bank of Japan, for the half-year ending December 31, 1930.

[3] Data collected from the various Semi-annual Balance-sheets of the Industrial Bank of Japan.

At the end of the half-year		Fixed Loans. Yen.
December 31, 1927	...	219,058,151
June 30, 1928	...	240,425,655
December 31. 1928	...	251,599,827
June 30, 1929	...	276,133,280
December 31, 1929	...	260,523,782
June 30, 1930	...	263,200,049
December 31, 1930	...	273,092,957
June 30, 1931	...	306,118,956
December 31, 1931	...	319,936,376
June 30, 1932	...	311,746,055
December 31, 1932	...	306,605,397
June 30, 1933	...	278,375,289

The rôle of the Bank as an industrial financier is not, however, confined to the provision of mortgage loans only. The Bank's issue business is even more important than its mortgage business. It plays a very useful part as an issue house, an investment banker and an underwriter. In this capacity it has assisted a considerable number of industrial companies by floating and underwriting the debentures issued by them. In fact the principal way in which it has financed industries has consisted in floating and underwriting these debentures. The shipping concerns have naturally received a large measure of its assistance in this respect but the assistance rendered to numerous public utility companies and industrial enterprises of various kinds has been no less considerable in the recent years. (1) Railways, (2) tramways, (3) electric power, (4) paper, (5) sugar, (6) cement, (7) water power, (8) motor bus, (9) rope manufacturing, and (10) artificial manure companies are, among others,

the principal industries whose debentures have been floated and underwritten by the Bank in present times. The issue business of the Bank is not, however, restricted to the underwriting of industrial debentures only, for the Bank has on numerous occasions acted similarly on behalf of the Government, municipal and local bodies.

In this matter of floating and underwriting bonds and debentures, the Bank sometimes acts alone and sometimes in close co-operation with other banks. There are at present about 15 banks in Japan, including the Industrial Bank, the Bank of Japan and the "Big Five" which usually act in close association with one another for the flotation of the securities. This policy of the Bank undoubtedly spreads out the risks of investmentfairly widely and is reminiscent of the practice of German banks.

Participation or subscription to share capital of industrial companies does not appear to constitute an important line of the Bank's business and it may be undertaken only with the sanction of the Minister of Finance. The provision of initial finance for fixed capital expenditure of industry is not, therefore, an essential function of the Bank. Its special business consists in the furnishing of capital for extension, modernisation and reorganisation of industry. We have very carefully studied the semi-annual reports of the Bank for a considerable number of years but nowhere have we come across an instance where the institution subscribed to or underwrote the shares of an industrial company, while the underwriting of debenture issues is the most important line of activity in every business year.

With a view to leading industrial finance to its normal channels, the policy recently adopted by the Bank has consisted in having its long-term loans to industry converted into debentures issued by them for the purpose. The Bank has directed its efforts to have such debentures issued on sound mortgages and a redemption fund has been provided for them.[1]

[1] Sixtieth and Sixty-third Reports of the Industrial Bank of Japan, December 31, 1931 and June 30, 1933.

We give below a classified abstract of the debentures of various companies floated and underwritten by the Industrial Bank of Japan either singly or in syndicates in recent years [1] :—

Description.	Amount issued. Yen.	Year of Issue. Half-year ending
I. Railway and Tram—		
South Manchurian Railway	10,000,000	Dec. 31, 1926
,, ,, ,,	20,000,000	June 30, 1927
Oji Electric Tram Co.	6,000,00	,,
Seibu Railway Co., (Second Debenture)	3,500,000	Dec. 31, 1927
(Third Debenture)	3,000,000	,,
South Manchurian Railway Co. (Twenty-seventh Debenture).	50,000,000	,,
Chichibu Railway Co.	3,000,000	June 30, 1928
South Manchurian Railway Co.	35,000,000	,,
Ina Electric Railway Co.	11,000,000	June 30, 1929
South Manchurian Railway Co.	35,000,000	,,
,, ,, (30th Deb.)	20,000,000	Dec. 31, 1930
,, ,, (31st Deb.)	30,000,000	Dec. 31, 1931
	2,265,000,000	
II. Electric Light and Power—		
Ina Electric Company	10,000,000	Dec. 31, 1926
Formosa Electric Power Co.	8 000,000	,,
Hakusan Water Electric Power Co.	4,000,000	,,
City of Tokyo Electric Enterprises Loan bonds.	3,200,000	,,

1. Data collected from various Semi-Annual Reports of the Bank.

Description.	Amount issued. Yen.	Year of Issue. Half-year ending
Azumi Electric Company	3,500,000	June 30, 1927
,, ,, (2nd Deb.)	1,000,000	Dec. 31, 1927
Daido Electric Power Co.	19,910,000	,,
Hakusan Hydro-Electric Power Co.	4,000,000	,,
City of Tokyo Electric Works.	41,5000,000	June 30, 1928
Hukusan Hydro-Electric Power Company.	4,000,000	,,
Ibigwa Electric Co.	10,000,000	Dec. 31, 1928
Morioko Electric Light Co.,	8,500,000	,,
Shinano Electric Co.	3,000,000	,,
Komatsu Electric Co.	1,200,000	,,
Formosa Electric Power Co.,	6,500,000	,,
Daido Electric Power Co.	15,000,000	,,
Tobu Electric Power Co.	14,000,000	,,
Nippon Kai Electric Co.	8,000,000	Dec. 31, 1929
City of Tokyo Electric Enterprises.	15,000,000	June 30, 1930
Fukushima Electric Light Company.	10.000,000	,,
Tobu Electric Light Co.	2,000,000	,,
City of Tokyo Electric Enterprise Short-term Loan.	17,560,000	Dec. 31, 1930
Hidachi Electric Power Co., First Series.	4,640,000	June 30, 1932
Chubu Electric Co.	3,000,000	,,

Description.	Amount Issued. Yen.	Year of Issue. Half-year ending
III. Cement—		
Yawagi Cement Co.	3,000,000	Dec. 31, 1926
Onoda Cement Co.	2,700,000	June 30, 1929
Chichibu Cement Co.	2,500,000	,,
Onoda Cement Manufacturing Company.	3,500,000	Dec. 31, 1929
Asano Cement Manufacturing Company.	4,640,000	June 30, 1932
	16,340,000	
IV. Sugar—		
Teikoku Sugar Refining Co.	5,000,000	Dec. 31, 1926
Teikoku Sugar Manufacturing Co.	5,000,000	June 30, 1929
	10,000,000	
V. Paper—		
Fuji Paper Mill Co.	10,000,000	Dec. 31, 1926
,, ,, ,, ,,	10,000,000	June 30, 1927
,, ,, ,, ,,	10,000,000	June 30, 1928
,, ,, ,, ,,	16,000,000	Dec. 31, 1928
,, ,, ,, ,,	30,000,000	June 30, 1929
	76,000,000	
VI. Shipping—		
Kakusui Steamship Co.	2,5000,00	Dec. 31, 1927
Nippon Yusen Kaisha	30,000,000	Dec. 31, 1928
,, ,, ,,	15,000,000	Dec. 31, 1929
	47,500,000	
VII. Rope Manufacturing—		
Tokyo Rope Manufacturing Company.	6,500,000	Dec. 31, 1928

Description.	Amount Issued. Yen.	Year of Issue. Half-year ending
VIII. Artificial Manure—		
Dai Nippon Artificial Manure Co.	9,500,000	June 30, 1929
IX. Motor Bus Enterprise—		
City of Tokyo Motor Bus Enterprise consolidated loan bonds.	2,497,000	Dec. 31, 1927
X. Waterworks and Drainage—		
City of Tokyo Water and Sewerage Works loan bonds.	3,846,000	June 30, 1927
City of Tokyo Waterworks and Drainage third loan bonds.	12,286,000	Dec. 31, 1927
City of Utsuno Miya Waterworks loan bonds.	897,000	Dec. 31, 1928
City of Tokyo Waterworks consolidated loan bonds.	17,440,000	Dec. 31, 1928

Besides the above, the Bank also assisted in floating and underwriting debentures of other industrial companies amounting to—

15,500,000 yen	during the half-year ending	30th June, 1931
18,000,000 yen	,, ,, ,,	31st December, 1931
175,000,000 yen (including 17,020,000 yen covering Municipal loan bonds of Tokyo plus 70,000,000 yen for the South Manchurian Company).	,, ,, ,,	31st December, 1932
97,000,000 yen	,, ,, ,,	30th June, 1933

In the post-war years the Industrial Bank of Japan has directed its attention chiefly to two problems—that of assisting the rationalisation movement among large industries and of providing finance to the smaller industries. Ever since the financial panic of April, 1927, the Bank has been earnestly endeavouring to exercise its functions as an industrial banking corporation by generously responding to the general tendency towards amalgamation and reorganisation that was an outcome of depression in a number of industries. In more recent years the Bank has come to play a very important part in the rationalisation of Japanese industry.

In many instances it has given its advice as to the proper method of reorganisation after an inspection of the affairs of the industry. In the case of a large number of financially embarrassed industries the Bank has actually taken part in their reorganisation.[1] With a view to their readjustment, improvement or expansion, the Bank has even drawn up plans or given advice for increase or decrease of capital, reduction of dividend or amalgamation or co-operation with another company. Thus in several cases where industrial concerns engaged in the same business were carrying on in uncontrolled competition with one another the Bank has called their attention to the value of working together and tried to lend an impetus to co-operative action and to put rationalised control into practice.[2]

It has in this manner actively assisted and initiated a large number of reorganisation schemes. The attitude of the Japanese Bank offers a sharp contrast in this respect to that adopted by the B. I. D. of England. With the authorities of the B. I. D., the guiding principle is that all schemes for rationalisation should come from within the industry. That the initiation of reorganisation schemes is not the function of banks, not even of such a specialist institution as the B. I. D., appears to be the prevailing banking view of the country. This policy adopted by

1 Sixty-first Report for the half-year ending 30th June, 1932

2 Fifty-ninth Report for the half-year ending 30th June, 1931.

the B. I. D., has been considered by many to have hindered the progress of rationalisation in English industry. The authorities of the Japanese Industrial Bank have taken an entirely different view. They believe that bankers "must support the rationalisation movement by understanding the nature of business enterprises and especially this Bank which has a special mission must work towards rationalisation." [1] The policy adopted by the Industrial Bank with the concurrence and co-operation of industrialists has borne fruit in Japan. Already some of the companies assisted by the Bank in this way are found not only to have remained secure in the matter of their finances but are also tending to show a marked improvement in their management. [2] It did its best for the improvement and readjustment of industrial business by furnishing loans or arranging for the funds necessary for the extension and reconditioning of industries irrespective of the size of the firms so long as they were favourable credit risks. [3] As a result new long-term loans made by the Bank rapidly increased. Between December 31, 1927, and June 30, 1930, the amount advanced to various big industrial companies was 67,789,000 yen. [4]

During the financial panic of 1927 and the acute industrial crisis of 1930, the Bank generously came to the rescue of a large number of industrial companies both large and small which fell into dire financial straits. Some of the most important industrial concerns were in great difficulties not only to meet their working expenses but also debentures and finance bills placed in the market which were due for repayment. When prices were rapidly falling and the market for securities was tottering on the brink of a severe collapse, the ordinary banks naturally hesitated

[1] Speech of the President Schimakichi Suzuki at the General Meeting of shareholders of the Industrial Bank held on 5th February, 1930.—Fifty-sixth Report of the Bank for the half-year ending December 31, 1929.

[2] Fifty-ninth Report for the half-year ending 30th June, 1931.

[3] Fifty-second Report for the half-year ending December 31, 1927.

[4] Fifty-eighth Report for the half-year ending 31st December, 1930.

to finance the business concerns in such a plight. But it was evident that there was a large number of industrial concerns which, having regard to their state of affairs and their management in the past, would not only be able to effect their reorganisation successfully before long, if financially aided, but would also continue as going concerns with further prospects for development in the future. Such enterprises undoubtedly deserved support. Under the circumstances, the institution, as the Governor pointed out in a recent Report, was not warranted in sitting still without adopting any measure to meet the situation, not only in the interest of national industries but also in the fulfilment of the mission and duties of the Bank. Accordingly steps were immediately taken to advance money to such business concerns as were considered to be sound and promising after a strict investigation. In the making of investigation, the Bank tried its utmost to be prompt and correct and advanced to the best of its ability to all those who were reasonably in need of money. [1] The Bank with the approval of the Minister of Finance undertook to finance the suffering companies and actually advanced them a lump sum of 70 million yen. [2] Mr. T. Yuki, the Governor of the Bank, took a leading part in assisting these concerns and his statesman-like action to a great extent averted the industrial crisis that was threatening to envelop the country in 1930. The timely assistance rendered by the Bank together with the reorganisation effected by the firms themselves contributed not only to their own rehabilitation but also to the improvement of the position of all the banks that had recklessly financed them.[3] The Bank directed its attention particularly to rationalisation of industries. In this connection it was soon realised that co-operation of bankers and industrialists was absolutely necessary to lend impetus to the rationalisation of industry.

1 Fifty-eighth Report for the half-year ending 31st December 1930.

2 *The Times Trade and Engineering Supplement*. Banking Number, June 27, 1931, p. 27.

3 *The Times Trade and Engineering Supplement*, Banking Number, June 30, 1934, p. 32.

The Bank endeavoured to cement more firmly the relations between itself and the industries which had obtained assistance from it. The institution also felt that it was necessary to see that the money supplied was put to the most efficacious, safe and sound use and for that purpose decided to go a step forward and share in the management and accountancy of the aided enterprises so as to ensure the safety of the money. Accordingly since 1930-31 whenever money has been advanced to industrial companies, the undertakings have not only been most carefully and deliberately investigated but have also been offered ever afterwards friendly advice as to their management as a whole or as to their accountancy. Able and competent men have also been installed in important places in the companies concerned.[1] This policy of co-operation initiated by the Japanese Bank in recent years is reminiscent of the practice of the Great Banks of Germany but the analogy is obviously not complete. In many instances friendly advice offered by the Bank has not followed the reorganisation but has preceded it.

It is interesting to note that the policy of co-operation with industrialists adopted by the Industrial Bank has had an important effect on the bankers in general. Many of them are taking the same course of action as the Industrial Bank and have entered into close association with the industrialists. "Industrialists and bankers have often had a heart to heart talk over the adoption of joint action for readjustment or betterment of the business management with the sole purpose of procuring a stable development for the enterprise."[2] The attitude of the Industrial Bank has not only engendered joint action and co-operation between bankers and industrialists but has even fostered a co-operative spirit among the leading bankers themselves and has brought about a re-orientation of the policy adopted by them in regard to industrial finance. An important step forward was

[1] Fifty-ninth Report for the half-year ending 30th June, 1931.
[2] *Ibid.*

taken towards the establishment of joint action and co-operation among bankers when the Industrial Investigation Association was formed a few years ago. The Association is an organ of enquiries for the sound investment of banks and other financial institutions. In view of the independent investment by banks in the past, the advent of the Association has been rightly viewed as the dawn of joint investment. Relying upon the activity of this Association and the results of its enquiries in a good many cases, the bankers have acted in concert or formed the financial syndicate in supplying the money. The investment in the Kyoto Muslin Company and others was a result of the league of the leading bankers.[1] Under the circumstances the authorities of the Industrial Bank have also recognised the desirability of the institution operating jointly to an increasing extent for the underwriting and issue of debentures of industrial companies.

In the recent years the Bank's policy has been chiefly to provide first of all money to those concerns which are urgently in need of financial readjustment so that they may effect such readjustment. Secondary consideration has been paid to demands for fresh money. Money has been supplied by making loans or underwriting the issue of debentures. With a view to leading industrial finance to its normal channels, the Bank repeatedly strove to transform loans into debentures or helped the companies to convert the higher interest-bearing debentures into lower interest-bearing ones, thus giving them relief in the conduct of their business or lightening their burden of interest. In this connection it is interesting to note that as the instrument of industrial finance the Bank adopted the positive policy of assisting even second class business concerns to readjust their internal affairs so as to be able to stand on their own legs. The policy pursued by the Bank in recent years in financing business concerns was outlined by the Governor at the general meeting of the

1 Fifty-eighth and Fifty-ninth Reports. Also *Japan, To-day and To-morrow* (1931-32), p. 50.

shareholders held on February 5, 1934: "Industrial companies in particular were enabled to secure a considerable reduction in their interest burdens through the conversion of some three-fourths of their debentures on more favourable terms. Almost all these loans were secured by mortgage and more than ten of the issue were raised on the 'open end mortgage' system. This improvement in the method of issue was of great convenience to industrial companies for they were enabled to float their loans on such a rational basis that they obtained in a large measure great advantage in the management of their business together with the material improvement of their position or its growth."[1]

More attention than in the pre-war years appears now to be directed towards the supply of long-term money. In financing industries long-term money has been supplied as far as possible, whenever the industrialists were considered to be fit persons, their business affairs were fairly sound and stable and their policy of readjusting or improving their affairs definitely known.

The Bank also tried to raise money for industrial companies desirous of obtaining it through the issue of debentures by underwriting it. But it was very difficult to obtain adequate finance from this source, the conditions in the money market being such as to make impossible the issue of debentures.[2]

The following principles have been laid down by the Bank in recent years, in close conformity with which the business of financing industries will be conducted henceforth[3]:—

1. The term of the loans is to be a long one.

2. The debentures should be issued on sound mortgages (of immovable property).

3. Good use is to be made of the principles of the sinking fund system.

[1] Sixty-fourth Report for the half-year ending December 31, 1933. See also the *Times Trade and Engineering Supplement*, Banking Number, June 30, 1934.

[2] Sixty-first Report for the half-year ending June 30, 1932.

[3] Fifty-ninth Report for the half-year ending June 30, 1931. Also Sixty-third Report for the half-year ending June 30, 1933.

4. Close touch should be maintained with the factory management.

Industrial Finance for Small and Middle Class Men in Industry:

Along with the rationalisation of industry, the special attention of the Industrial Bank in the post-war years has been directed towards the provision of finance for small and middle-sized industries. In the beginning the Bank was specially interested in the heavy industries. Other large-scale industries and public utility companies gradually came to obtain a considerable measure of the Bank's assistance. The assistance of the Bank is no longer confined to the large-scale industries only. On the contrary the Bank has been taking the greatest pains for financing small industries. It has now acquired more than 15 years' experience since the policy of financing small industries was begun by the Bank; and since the earthquake of 1923 and particularly since the financial panic of 1927, the Bank has been exerting itself in this direction even more actively. It has been recognised that an urgent need of the present times is finance for small industrialists and it has been the declared policy of the Bank in recent years to make particular and constant endeavour to supply their financial requirements. The provision of financial facilities for small industries is receiving the increasing attention of the Bank and an improvement is being achieved almost every year in this line of business. A careful perusal of the semi-annual reports of the Bank discloses that the institution is constantly alive to the difficulties experienced by small- and medium-sized industries in raising their required finances; and is persistently moved by an intense desire to do all it can for them.

In the latter half of 1931 the Bank took steps to enlarge yet further its policy of financing small industries and to increase its efforts in that direction. Towards the close of 1932 a further necessary extension was made in the facilities of this particular department of the Bank's business and an improvement was

also achieved in the methods of operation. It increased the number of staff in charge of this particular department of operations and scrutinised closely the real situations in the enterprises involved in order to meet their needs justly, promptly and appropriately.[1] Before granting its assistance, the Bank conducts a close investigation into the personal and material credit of the applicants as well as into the conditions of the business. Assistance is rendered to such concerns only which have been fairly good or are likely to grow with such help.

Advances are made to the small industrialists on the security of factory, machinery, and real estate. But attention is not exclusively confined to the material credit of the applicants for loans. Their personal credit is also taken into account. There are several instances where material security has been absolutely disregarded. Where the borrowers have been of particularly reliable character and ability and have been able to show excellent business records, the Bank has not hesitated to meet liberally the financial needs of these enterprising men, even if they have been unable to offer adequate material security. The Bank has adopted since 1930 another policy for financing small industries. As the security offered by small and middle-class men in industry is in the main deficient, the Bank has decided to have recourse to the plan of making a loan to a group, the members of which will be individually liable for a fixed amount.[2] A constant watch is kept over the management of the concerns after they have received the assistance of the Bank. The attitude of the Bank to the small industries appears to be markedly sympathetic and full of solicitude for their welfare. Even in those cases where the Bank finds itself unable to offer its assistance on account of something being wrong with their management, it does not, as a rule, show its cold shoulders and drop them out at once. On the contrary, it carefully examines any such defect, and with a view to improving their

[1] Sixty-second Report for the half-year ending December 31, 1932.

[2] Fifty-eighth Report for the half-year ending December 31, 1927.

condition it offers itself as their adviser and takes a great deal of pains to point out to them what means should be adopted to put their house in order. Thus the door is not shut against their future financial assistance and the policy actually paves the way for the provision of financial facilities at some other time.[1]

The results of the policy have been particularly happy. Many businesses, otherwise indifferent in the management of their affairs, have actually bestirred themselves to improve their condition and get into a position to qualify themselves to obtain an accommodation from the Industrial Bank. In financing small industries as in the case of large industries the Bank has not simply supplied the money but in co-operation with the industrialists has also given them its good offices for readjustment or improvement of their business.[2] Financing of small industries in small amounts has now extended over the whole country. Having regard to the real needs in the industrial centres throughout the country, the Bank is trying to facilitate still further this kind of financing by making enquiries into applications even from remote places or making provision for facilities of several other kinds. The Government of Japan which take a great deal of interest in the welfare of small industries have utilised the Industrial Bank as a channel, since the earthquake of 1923, through which to extend their financial assistance to small men in industry. The Deposits Bureau of the Government decided after the panic of 1927 to loan 50 million yen to small borrowers through the Industrial Bank, the Hypothec Bank and the Co-operative Societies' Central Bank. The rate of interest for these loans was 5% to 6½% and the maximum was limited to 3,000 yen. Again, we find in a Report of the Bank that when the Government decided some time ago to advance for industrial purposes to the small industrialists and traders in the area covering 2 urban and 17 prefectures, as much as

[1] Sixtieth Report for the half-year ending December 31, 1931.

[2] *Ibid.*

10,271,000 yen was apportioned to the Industrial Bank. The Bank determined the terms of advances to these classes in the three cases, *viz.*, of making the loans directly, through ordinary banks, and through the associations of the industries and export trade. Financing of small industries was further facilitated in this way. The assistance rendered by the Industrial Bank to small industries has been particularly great after the earthquake and the financial panic of 1927. Besides the usual advances, emergency loans with a special lower rate of interest were frequently made. The Bank has financed various kinds of small businesses covering many ramifications of the manufacturing industry. The chief among them are sawing, wood-working, furniture, printing, book-binding, machines, tools, ice-making, celluloid articles, plating, glasswares, food, hosiery, textile goods, dyeing and rubber. Figures showing total advances and the number of accounts in which they were made are available for the following small industries[1] :—

Small Industries.	Total Advances (in millions of yen).	Number of Accounts.
1. Machinery manufacturing	6·0	217
2. Chemicals	4·9	299
3. Saw milling	4·7	217
4. Printing and Bookbinding	4·3	289
5. Spinning and Weaving	4·0	401
6. Foodstuffs	3·7	319

An analysis of the advances made by the Industrial Bank conveys the definite impression that loans to smaller or minor industries are rapidly mounting. During the half-year ending on 31st December, 1927, of the total amount of loans for the term, *viz.*, 307,794,000 yen, loans for smaller industries amounted to

[1] Herbert Bratter, *Japanese Banking*, p. 181.

12,390,000 yen.[1] In the next half-year ending on 30th June, 1928, 24,090,000 yen out of a total amount of loans of 314,640,000 yen were advanced to smaller enterprises, the borrowers numbering 1,369. The emergency loans with a special lower rate of interest already referred to for business enterprises in the local districts totalled 897,730 yen.[2] For the next term which ended on 31st December, 1928, loans to the smaller industries rose to 28,487,000 yen, the borrowers numbering 1,764 out of a total loan balance of 323,824,000 yen. The emergency loans during the same period amounted to 1,635,000 yen, the number of borrowers being 763.[3] At the end of the term on 30th June, 1929, the amount loaned for small industries was 19,170,000 yen out of a total amount of loans of 350,960,496, the number of borrowers being 1,770.[4] During the next period, *i.e.*, the half-year ending on 31st December, 1929, such loans amounted to 22,764,759 yen out of a total of 380,630,073 yen, distributed among 3,039 borrowers.[5] The following table illustrates the rapid growth of such loans in more recent years[6] :—

Half-year ending	Advances to small Industries. (Yen.)	Number of Borrowers.	Total Advances. (Yen.)
June 30, 1930	23,100,482	3,422	379,663,000
Dec. 31, 1930	1,418,100	328	69,207,000
June 30, 1931	45,390,000	4,521	,456,600,000
Dec. 31, 1931	50,243,000	4,845	486,003,000
June 30, 1932	52,197,000	4,964	484,110,000
Dec. 31, 1932	53,248,000	5,035	476,090,000

The figures given above strikingly illustrate what an important proportion of the total loans of the Bank is made up

1 Fifty-second Report of the Industrial Bank of Japan, December 31, 1927.
2 Fifty-third Report of the Industrial Bank, June 30, 1928.
3 Fifty-fourth Report of the Industrial Bank, December 31, 1928.
4 *Fifty-fifth* Report of the Industrial Bank, June 30, 1929.
5 Fifty-sixth Report of the Industrial Bank, December 31, 1929.
6 Data collected from various Semi-Annual Reports.

of the small loans business. Such loans showed a remarkable tendency to increase and reached the peak at the end of December, 1931. There was a tremendous rush of applications for loans from small industrialists in that year. But since then the demand for loans from them has tended to decline. This is partly due to the economic recovery of the world, but partly due, doubtless, to the fact that the Bank had supplied ample funds when they were urgently in need of assistance. Thanks to the Industrial Bank's efforts, they are now very well financed.[1]

As regards the result of the business operations of the Bank, although it incurred severe losses owing to depreciation of real estate and security values when the shipbuilding and other industries were caught in the post-war slump, it is satisfactory to note that the institution has achieved a fairly favourable record in recent years. The result of the loans has been in general very good. The assistance rendered by it in the sphere of industrial reorganisation has promoted a great deal the rationalisation movement in Japanese industry. Its mission as one of the special financial institutions of the State has been accomplished to a great extent. Borrowers both large and small of the Industrial Bank have been able to repay their loans generally; and even the money that was advanced during the industrial crisis of 1930 has been collected fairly largely. The policy adopted by the Bank in helping industrial companies to convert their loans into long-term ones or debentures issued by them has in a great measure been responsible for this collection. Thus the borrowers were not only relieved from anxiety about their finances but the crisis in the industrial circles was also averted. This, as the Governor observed in the 59th Report, must be regarded as the fulfilment, in part, of the functions of the Bank to the satisfaction of all. The recent business reports of the Bank amply show that it has exerted its full strength for the execution of its mission as a special financial institution. It has

[1] Sixty-third Report of the Industrial Bank of Japan, June 30, 1933.

maintained its established policy and has continued its efforts to render financial assistance to its clients and industrial companies for ensuring their sound financial standing and expansion in their business undertakings. It performs a very important function in the industrial life of Japan. At no time perhaps have its services been more needed than during the world depression. Ever true to its mission and faithful to its traditions, the Bank has risen to the height of the occasion and has generally extended its sympathy and assistance to the sorely stricken industries of the country. In assisting a large number of industries, it has, however, observed a cautious and discriminating policy, insisting, wherever necessary, on reorganisation and rationalisation as a condition of its assistance.[1] The industrial crisis which was threatening to envelop Japan in the autumn of 1930 was, it may be recalled, averted by the statesmanlike action of Mr. Yuki, the Governor of the Bank.

The industrial development of Japan has progressed at immensely rapid strides. Between 1895 and 1928 she achieved an almost spectacular development and her mainstay was transformed from agriculture to industry. In estimating the share of the Industrial Bank in this amazing industrial progress of Japan, however, the influence of other factors should not be forgotten. *The Industrial Bank is not the only factor in* Japanese industrial financing. The Hypothec Bank, which was designed on the lines of the French 'Credit Foncier' to make loans on immovable property, also engages actively in industrial financing. The Deposits Bureau of the Government lends considerable sums through the Bank to smaller industries. In recent times the Bureau has also begun to play an interesting part in underwriting debenture issues. In 1929 it was reported to have underwritten a 20 million yen Daido Electric Power Company issue. The part it took in the post-war financing of industry has been remarkable. It is ever extending its activities

1 *The Statist*, November 17, 1931, *International Banking Section*, p. 757.

and in 1929 it was announced that it would advance money on security of fire-proof and quake-proof buildings in Tokyo and its vicinity.[1]

The local agricultural and industrial banks, which are in effect branches of the Hypothec Bank in different prefectures, also play a part in the financing of industries because, besides making loans to agriculturists and public bodies, they extend their assistance to manufactures also.

The commercial banks of Japan have also a share in industrial financing. There is a persistent tendency on their part to make extensive loans by way of accommodation to industrial concerns. In more recent times, it may be recalled, owing to an influx of deposits into the commercial banks especially after the 1927 crisis, their tendency for industrial financing has considerably increased. Instead of competing with one another to attract deposits, they are now competing in underwriting the issue of debentures.[2] Besides the commercial banks, savings banks play an important part in industrial financing, as they are large holders of securities. At the end of June, 1929, they held 852,955,900 yen so invested, as compared with 3,277,732,000 yen held by ordinary banks and 754,657,000 yen held by the special banks.[3] Judging from conditions of March 31, 1929, one-half of the securities held by the savings banks consists of other than Government bonds. These savings banks are permitted to take up or purchase, with the approval of the Minister of Finance, debentures and stocks of companies and to make loans on pledge of the said securities and also on mortgage of real estate. This activity of the Japanese savings banks is somewhat akin to that of their American rivals but the latter are invariably restricted to first class bonds only (and not shares also) in the matter of their investments.

[1] *Japan Advertiser*, April 9, 1929, p. 7.

[2] *The Times Trade and Engineering Supplement*, Banking Section, June 29, 1929, p. 31, and June 28, 1930, p. 25. See *supra*, Ch. IV.

[3] Herbert Bratter, *Japanese Banking*.

Private bankers like the famous houses of Mitsubishis, Mitsuis, Sumitomos and Yasudas have also been responsible for many of the new industries of Japan. These powerful bankers have extended their activities in the industrial field. There are probably few enterprises of importance in Japan in which at least one of the groups has no interests. The most powerful banking houses are primarily industrialists themselves.

The insurance companies of Japan have considerable investments in mortgages on real estate and on factories as well as in security loans. Thus they also play a large part in the long-term financing of industry. Their investments and loans on security have been rapidly mounting in recent years.[1]

Last but not least, the rôle of the Government must not be forgotten in this connection. They have had a big share in the rapid industrialisation of the country.

Without attempting to minimise the importance of other factors in Japanese industrial financing, it must be recognised that the Industrial Bank had a considerable share in financing the economic development of the country. At the same time, however, it must be pointed out that the Government of Japan completely identified itself with the working of the Bank. Indeed, the Bank would have found it difficult to function, if the Government had not taken such a keen interest in its affairs and had not helped it with the immense resources of the Deposits Bureau and in various other ways.

1 Thirty-fourth Financial and Economic Annual of Japan, 1934, pp. 112-13.

CHAPTER X

Industrial Mortgage Banks in Post-War Europe[1]

I. *The Industrial Mortgage Bank of Finland, Ltd.*[2]

The Industrial Mortgage Bank of Finland is one of the earliest and most important of the institutions that have been established in post-war Europe to grant long-term credit to industry through the issue of mortgage bonds. The name of the Bank in Finnish, as given in the Articles of Association, is "Suomen Teo-llisuus-Hypoteekkipankki O. Y." and in Swedish "Industri-Hypoteks banken-i-Finland A. B." It was founded in 1924 with a paid-up share capital of 50 million Finnish marks, divided into 5,000 shares of 10,000 marks each. It was empowered to issue bonds. By an amendment of the Articles of Association, made on April 11, 1934, the total amount of the outstanding bonds of the Bank was limited to ten times the amount of its share capital and reserve fund. The Bank was further entitled to take up short-term credit not exceeding double the amount of the Bank's own funds, provided the security for the credit did not consist of the Bank's own bonds.[3]

For some time before the establishment of the Bank negotiations had been taking place between the Bank of Finland and the largest jointstock banks and the leaders of Finnish industry for the purpose of establishing a mortgage bank for the industries of the country. The idea was to obtain capital from foreign

[1] The substance of this Chapter appeared in the form of a series of articles in the *Calcutta Review*, June, July and September, 1934.

[2] The entire information about this Bank has been obtained direct from Finland. Mr. Gustaf Fogelholm, the Managing Director of the Bank, kindly replied to a detailed questionnaire framed by the writer and also furnished him with the Annual Reports, Balance-Sheets, and Articles of Association of the Bank.

[3] Chapter II, Sec. 8, Articles of Association (Amended), 11th April, 1934.

countries on reasonable terms by means of bond issues and to use the funds thus obtained for advancing amortisation loans to industrial enterprises on mortgages of their real estate, ground, forests, water-power and factory buildings. The plan attracted the attention of the Government, who considered the matter to be one of great public interest and on the 26th May, 1924, laid before the Diet a proposal for a State guarantee of a foreign loan not exceeding the equivalent of 550 million Finnish marks.[1]

The scheme submitted to the Government for the statutes of the proposed Bank was confirmed on 5th June, 1924, and the constituent meeting of the shareholders of the Bank was held on the following day. It was announced in the meeting that the entire share capital of the Bank had been paid up on the same day. The shares were divided into two series, of which 80% belonged to series 'A' and 20% to series 'B.' The 'A' series of shares was taken over by the founders, the participating banks, *viz.*, A. B. Nordiska Forenings banken, Kansallis-Osake-Pankki and Helsingfors Aktie bank; the remainder, the 'B' series of shares, was to be taken over by those owners of industrial enterprises who would receive financial assistance from the Bank to an amount equal to a fixed percentage of their borrowings.[2]

The object of the Bank is to supply the long-term credit requirements of the industries of Finland by granting amortisation loans to industrial enterprises on mortgage of their real estate, ground, machinery, forest, water-power and factory buildings in Finland, in accordance with the law for mortgage in force.[3] It does not provide initial capital to industrial concerns by subscribing to or underwriting their shares. The provision of working capital to industry is not also its business.[4] The amount of loan granted in each case should not exceed 50%

1 Report of the Industrial Mortgage Bank of Finland, Ltd., 1924, Helsingfors, 1925.

2 Letter to the writer from the Managing Director, Mr. G. Fogelholm, in reply to a questionnaire, dated 6th November, 1934.

3 Ch. I, Sec. 1, Articles of Association, 1934.

4 Letter to the writer from the Managing Director of the Bank, *op. cit.*

of the appraised value of the industrial property mortgaged. Two unprejudiced specialists are to be employed by the Board of Directors for the purpose of valuation. In assessing the value of the property, attention should be paid not simply to its value as such but also to the security which the undertaking represents by its remunerativeness in regard to payment of interest and amortisation. The period for amortisation of loans is not to be more than 25 years.[1] The buildings and machinery belonging to the borrowing industrial undertaking must be insured against fire in an institution approved by the Board before a loan can be granted. According to Sec. 6 of the Bank's statutes, the borrowing enterprise shall also furnish, besides the mortagage deed for the nominal value of the loan, a separate interest-bearing undertaking for an amount equal to 5% of the nominal amount of the loan, as security for which a mortgage shall also be obtained.[2] The Bank cannot lend more than 15% of its total borrowing to one and the same industrial undertaking.[3]

The Board of Directors of the Bank consists of seven members, of whom one member is appointed according to the instructions of the Ministry of Finance because of the guarantee given by the Finnish State to the bond loans taken up abroad by the Bank. This member participates in the management of the Bank on the same right and in the same way as the other members of the Board. The other members are elected by the participating banks and the borrowers of the Mortgage Bank. Originally it was laid down by the statutes that the owners of shares belonging to series 'A' should elect 3 members and those of shares belonging to series 'B' another 3 members. At a special meeting of the shareholders held on 25th June, 1924, the statutes were altered, in compliance with the wishes of the syndicate granting the bond loan, in such a manner that the holders of 'A' shares would elect 4 members and those of 'B'

[1] Ch. II, Sec. 5, Articles of Association.

[2] Ch. II, Sec. 6

[3] Ch. III, Sec. 7.

shares 2 members.[1] The amendment was confirmed by the Government on 10th July, 1924. The duties of the Board of Directors are as follows :—

(*a*) To guide the management of the Bank's business in accordance with the law and the articles of association and the decisions of the meetings of shareholders ;

(*b*) To determine the bases and detailed instructions for the valuation of property on which loans are to be granted ;

(*c*) To decide as to the issue of bond loans and other loans on behalf of the Bank and as to the security to be provided for them ;

(*d*) To determine the general conditions of loans ;

(*e*) To decide as to the purchase and sale or mortgaging of bank property and as to the purchase and sale of such property as the bank is obliged to take over unsettled claims ;

(*f*) To have the cash of the bank, its stocks and other assets checked at least twice a year by auditors appointed for that purpose from among its members ;

(*g*) To engage and dismiss a managing director of the Bank and determine his remuneration ;

(*h*) To issue and cancel powers of attorney.

The Bank has to transfer 25% of its annual profits to a Reserve Fund until the fund amounts to 25% of the share capital and thereafter not less than 5% until the reserve fund amounts to 50% of the share capital. A dividend not exceeding 6% may only then be paid out to shareholders. Of the balance remaining, one-half shall be transferred to a fund for redeeming the guarantee undertaking referred to above.[2] The remainder is at the disposal of the meeting of the shareholders. The loss in any year is to be covered in the first instance by unappropriated profits and the reserve fund. But if these are not sufficient to

[1] Ch. III, Sec. 17, Articles of Association.

[2] See Sec. 6 of the Articles of Association.

cover the loss, the Bank is entitled to have recourse to the undertakings delivered by the borrowers in addition to the mortgage deeds, the required amount being divided among all the borrowers in proportion to the outstanding amounts of loans.[1]

The Bank's. negotiations for obtaining a bond loan from abroad were completed early in July. An American consortium with Messrs. Lee Higginson of Boston at its head, agreed to grant to the Bank a bond loan of 12 million dollars at 7% interest; and the agreement was signed on the 7th of July in London. As soon as the bond loan was settled, the Board took steps to organise the business of the Bank with great care and effort. The principles and manner of valuing the different forms of real estate to be mortgaged as security by the borrowers, forest land, machinery, and water power, were carefully determined; and a staff of technical experts was employed to assess properly the value of these properties. Thus at a meeting of the Board held on 2nd August, 1924, separate "assessors" were appointed for valuing different forms of industrial property: two for buildings and machinery, two for landed and forest property and three others (two being regular and one a substitute) for water power. In consultation with these "assessors" the Managing Director framed questionnaires to which prospective borrowers were required to reply. Besides these specialists, the Board had already selected as early as July three other gentlemen to participate in the capacity of experts in the decision of important questions by the Board.[2]

At meetings of the Board, held on 30th July and 4th August, 1924, terms were drawn up for the amortisation loans which the Bank would grant out of the funds secured by the bond loan on real estate security as prescribed by the statutes. The debt undertakings were to be made out in dollars and would bear

[1] Ch. IV, Sec. 23.

[2] Report of the Industrial Mortgage Bank, Finland, 1924, Helsingfors, 1925.

interest at $7\frac{1}{2}\%$ and be amortised by means of equal payments to be made semi-annually during the same period as the Bank's bond loan, *i.e.*, 20 years reckoning from 1st July, 1924. The same capital rebate as allowed on the Bank's loan would also be allowed on the amortisation loans. These terms were outlined in detail in a prospectus which was issued to owners of Finnish industrial concerns.

The Bank began operations on 21st August, 1924. Applications to be sent in before the 15th of October were invited for loans from owners of industrial concerns in Finland by issuing notices in the press. One hundred and five applications for loans were received, amounting to a total of 560,255,000 Finnish marks. These applications were dealt with during October, November, and December. Sixty-two applications totalling 41,680,000 Finnish marks were refused and 27 amortisation loans were granted altogether for 387,824,814 Finnish marks equivalent to $9,768,887 (at an exchange of 39·70). Of this sum 259,787,311·70 Finnish marks (equivalent to $6,543,761) were taken up during the year. There still remained 16 applications amounting to 130,750,186 Finnish marks to be dealt with while, of the funds obtained through the bond loan, 76,665,186 Finnish marks only were still available for disposal, when the year closed.[1]

The value of the property mortgaged by the borrowers as security for the amortisation loans granted during the year was assessed at Finnish marks 1,060,678,701·25. The loans granted thus represented on an average 36·6% of the assessed value of the mortgaged properties and afforded ample security to the Bank.

After five years, the Bank was again able in 1930 to assist Finnish industry by the grant of amortisation loans. It took up in that year a fresh bond loan of £2,000,000 at 6% to be redeemed by annual instalments in 25 years (15th April, 1955). The contract for the loan was concluded on April 15, 1930,

1 Report of the Industrial Mortgage Bank of Finland, 1924, Helsingfors, 1925.

between a syndicate composed of several financial institutes,[1] the Bank and the Government of the Republic of Finland which signed a guarantee for the loan. According to the terms of the contract the proceeds of the bond loan were to be employed for granting amortisation loans to industrial concerns in Finland against a first or second mortgage on real estate belonging to them. The mortgage deeds of the amortisation loan were to be deposited with the Ministry of Finance as soon as they were duly completed. The proceeds of the bond loan were paid to a special account in the Bank of Finland. The Industrial Mortgage Bank would have to produce a certificate from the Minister of Finance that the mortgage deeds had been deposited with the Bank Inspectors, or other approved securities equivalent to a corresponding amount had been presented, whenever it wanted to draw upon the proceeds of the bond loan deposited in the Bank of Finland. As the completion of mortgage deeds takes a long time in Finland, the Board of Directors of the Mortgage Bank submitted to the Minister of Finance that the joint sureties of the three participating banks should be aceccpted as the temporary security. It was also proposed that, in those cases in which the mortgages could not be completed at once, the Bank would pay the amounts of the loans for the amortisation loans granted on the temporary surety of one of these banks, in which case the joint surety of the three banks should remain in force, until all its mortgage deeds duly completed had been deposited with the Bank Inspectors, to whom the Ministry of Finance had entrusted the charge of these documents. The proposal was approved on 15th April, 1930, and immediately afterwards the joint surety undertakings of the three shareholding banks were deposited there. The terms for the amortisation loans to be granted out of the proceeds of the bond loan were decided by the Directors at

[1] They were—Hambros Bank, Ltd., London; J Henry Schroeder & Co., London; Mendelssohn & Co., Amsterdam; Nederlandsche Handel Maatschappij N. V., Amsterdam; Stockholms Enskilda Bank, Stockholm; the Bank of Finland, A. B. Nordiska Forenings banken, Kansallis-Osake-Pankki and Helsingfors Aktiebank, all in Helsingfors

their meeting held on the 23rd of April, 1930. The same term of amortisation was fixed as for the bond loan: the same capital rebate was also to be allowed as on the Bank's bond loan. The annual instalments were to be paid every six months at the rate of 3·995% of the nominal amount of the loan, equivalent to an annual rate of interest of 6·2%. The mortgage deed and the guarantee of 5% of the amount of the loan as demanded by the statutes of the Bank were to be made out in pounds sterling.[1]

As before, notices were issued in the press inviting applications for loans from Finnish industry. During May, 1930, 128 applications were received, totalling Finnish marks 938,272,150. One hundred of these were refused and one was left undecided, the valuation not being ready when the year closed. The remaining 27 applications amounting to Finnish marks 380,302,350 (£1,971,500) were granted. The total assessed value of the industrial property hypothecated to the Bank as security for the loans granted amounted to Finnish marks 1,188,650,746. The amount of the loan, therefore, represented 32% of the total mortgage valuation. But in several cases the securities of the loans granted consisted of second mortgages. There were earlier mortgages on the property amounting to Finnish marks 126,209,960 or 10·6%. These mortgages consisted mostly of the securities for the dollar loans issued by the Bank in 1924 and 1925.

By 1932 the mortgage deeds for the 45 mortgage loans granted out of the funds obtained by the Bank from the bond loan of 1st July, 1924, were duly registered and deposited with the Bank Inspectors. Of the 28 mortgage loans granted from the proceeds of the bond loan of 15th April, 1930, 20 were also duly registered and deposited. No new mortgage loans were granted during 1932[2] and 1933.[3] A new 6% bond loan of Fmk. 200,000 for 5 years was issued by the Bank in 1934. The object was to

1 Report of the Industrial Mortgage Bank of Finland, Ltd., 1930, Knopio, 1931.
2 Report of the Industrial Mortgage Bank of Finland, Ltd. 1932, Kupio, 1933.
3 Report of the Industrial Mortgage Bank of Finland, Ltd., 1933, Helsingfors, 1934.

obtain the necessary funds for redeeming the entire outstanding amount of $6,300,000 of the bond loan of 12 million dollars issued in the United States in 1924. The Government transferred to this loan the State guarantee granted on the dollar loan. It was underwritten by a syndicate consisting of A. B. Nordiska Forenings banken, Kansallis-Osake-Pankki and Helsingfors Aktie bank.[1] In accordance with a decision of the Board of Directors, 11 mortgage loans were granted during 1935 to the total amount of Fmk. 47,500,000 out of the funds deposited in Finnish banks.[2] The Bank has furnished assistance to middle-sized firms as well as larger industrial concerns. Its assistance has generally been confined to the export industries, owing to the conditions of the guarantee granted by the Government for its bond issues. Both the bond loans of 12 million dollars and 2 million pounds have been guaranteed by the Government. There is no system here, as in the case of the Industrial Bank of Japan, of the Government lending to it at favourable rates of interest. The Bank does not work as a commercial bank but only for its industrial customers. It makes no short-term loans; it discounts no bills; and it accepts no deposits, either long or short.[3]

The financial results of the Bank's business, as seen from the latest balance-sheets and profit and loss accounts, are not unsatisfactory. The annual profits for 1930, 1932, 1934 and 1936 are found to be Fmk. 651,346·19, Fmk. 3,237,122·03, Fmk. 1,270,081·41, and Fmk. 30,11,397·36 respectively. In estimating the profits of the Bank, the high amount of taxation paid should be taken into consideration. Finnish limited liability companies have to pay an unusually heavy income-tax as well as a tax on property. The amount which the Bank has to pay as taxes every year is not inconsiderable.[4] This acts as a great

[1] Report of the Industrial Mortgage Bank of Finland, Ltd., 1934, Helsingfors, 1935.

[2] Report of the Industrial Mortgage Bank of Finland, Ltd., 1936, Helsingfors, 1937.

[3] Source: Letter from Mr. Gustaf Fogelholm, the Managing Director of the Bank, dated 25th September, 1933, replying to a questionnaire framed by the writer.

[4] For instance, the Bank paid as taxes Fmk. 539,036·60 in 1930 and Fmk. 789,045·70 in 1932.

burden on the institution and puts great difficulties in the way of its fulfilling the task of arranging cheap long-term credits for Finnish Industry.[1] It is satisfactory to note that as regards its mortgage loans, the Bank has not been obliged to protect its rights at any forced auction nor to resort to any other legal measures for collecting its claims.[2]

To carry out redemptions, the necessary amount of bonds is purchased in the open market in London, Amsterdam, Stockholm and Helsingfors. Bonds are also often purchased for subsequent redemptions generally when the prices are low. The Bank's own bonds outstanding at the end of various years between 1924 and 1934 are given below[3] :—

1924	1930	1932	1933	1934
476,400,000	719,910,000	645,511,290	613,556,307	8,753,319

II. *The National Hungarian Industrial Mortgage Institute, Ltd.*[4]

Like the Industrial Mortgage Bank of Finland, the National Hungarian Industrial Mortgage Institute has been specially designed for granting long-term amortisation loans to the industries of Hungary. It was founded in 1928 by the Royal Hungarian Treasury and the National Union of Manufacturers (Gyariparosok Országos Szövetsegé)[5] of Budapest under Law XXI of the same year. Unlike the Finnish institution, the State participates here in the share capital of the Institute. The Royal Hungarian Treasury subscribed to 80% of its original capital which amounted to 10 million pengos (*i.e.*, $1,749,000) consisting of 10,000 shares,

1 Report of the Industrial Mortgage Bank of Finland, Ltd., 1930, Kuopio, 1931.

2 Report of the Industrial Mortgage Bank of Finland, Ltd., 1936, Helsingfors, 1937.

3 Balance-Sheets of the Industrial Mortgage Bank of Finland, Ltd., for the years 1924, 1930, 1932, 1933 and 1934.

4 The requisite documents were obtained from the authorities of the Institute in Budapest with the assistance of the Royal Hungarian Consul in India.

5 "Federation of Hungarian Factory Industries."

each share having a nominal value of 1,000 pengos. The remaining 20% of the shares was subscribed by the National Union of Manufacturers and its Industrial Member Unions. According to the Articles of Association, only 30% of the original capital had to be paid forthwith.[1] According to the latest balance-sheets available, 60% of the authorised and issued capital of the Institute, *i.e.*, 6 million pengos, has been paid up. The Royal Hungarian Government exercises supreme control over the Institute through its Minister of Finance. The latter appoints a commissioner who permanently supervises the carrying on of the business of the Institute in accordance with the Law and Articles of Association and also controls the issue of bonds, which must bear his certificate. He has access to all papers and documents and is bound to attend the General Meeting of the Institute and may attend any meeting of the Board of Directors and of the Council of Supervision. Any resolution passed by the General Meeting or the Board which is not consistent with the Laws or Articles of Association of the Institute may be vetoed by him within 8 days from the passing of such resolution. All resolutions vetoed in this manner are to be held in abeyance pending the decision of the Minister of Finance.[2]

According to the Articles of Association, the Board of Directors is composed of not less than six and not more than twelve members elected by the General Meeting of the shareholders for one year each. At least two-thirds of the Board of Directors must be citizens of Hungary. Any person who holds any office or employment with any other Hungarian Institute having a similar scope of business or with any financial institute having close connections with industrial enterprises is debarred

[1] Articles of Association of the National Hungarian Industrial Mortgage Institute, Ch. II, para. 6.

[2] Chapter VIII, paras. 39-41 of the Articles of Association, adopted at the constituent meeting of the Institute on 29th August, 1928; approved by the Royal Hungarian Minister of Finance in concurrence with the Royal Hungarian Minister of Commerce and the Royal Hungarian Minister of Justice.

from being elected to the Directorate.[1] No loan can be granted if objections are raised by two or more members of the Board of Directors The Board has been empowered with due consideration of the powers of the Government and Trustee of the Bondholders—

(1) To pass resolutions in matters of loans to be granted by the Institute;

(2) To appoint, discharge and pension officers of the Institute; and

(3) To decide upon—

(a) the calls to be made in respect of uncalled share capital;

(b) the type, the conditions and placement of the issues of the Institute;

(c) the form and text of the bonds to be issued; and

(d) how the share capital, the sinking fund, the funds for specially securing the bonds and the reserves shall be invested and made productive.[2]

Besides the General Meeting of the shareholders and the Board of Directors, there is a third organ of the Institute, *viz.*, the Council of Supervision. This Council is composed of not less than three and not more than five members who are annually elected by the General Meeting. No member of the Council can accept an office or employment with any other financial institute in Hungary as conducting similar business. At least three of the members must be citizens of Hungary. The Council supervises the carrying on of the business of the Institute in all its branches. It can always inspect the books, papers and cash in hand of the Institute. It is also empowered to examine the annual accounts and the balance-sheets which must be submitted to it by the Board as well as the proposals as to appropriation of profits and must report to the General Meeting on all these points.[3]

1 Articles of Association, Ch. IV, para. 25.

2 Articles of Association, Ch. IV, para. 28.

3 Articles of Association, Ch. IV, paras. 30-31.

The objects of the Institute are to carry on exclusively the following business transactions, *viz.* :—

(1) To grant, either in Hungarian or any other currency, loans, secured by mortgages registered in the Central Register of industrial enterprises in accordance with the Law XXI of 1928, to Jointstock Companies and Co-operative Associations carrying on industrial enterprises.

(2) To issue first mortgage bonds on the basis of loans secured on the mortgages enumerated in the preceding paragraph, made out in the same currency in which the claims constituting the underlying security of the issue are made out. [1]

The Central Register of industrial enterprises referred to above is kept in the Royal Court of Justice in Budapest and contains provisions enabling enterprises registered therein to mortgage not only their land and immovable assets but also their machinery, plants, stocks, work in progress, book debts and other current assets. [2] Such mortgaging, however, allows the mortgagor to carry on the business of the industrial enterprise and to conclude legal transactions connected therewith and incidental thereto, alienating his movable assets and pledging them in favour of third creditors. [3]

The issues of the first mortgage bonds of the Institute must be made with the approval of the Government Commissioner and the Trustee of the Bondholders whose representative, like the Government Commissioner, has access to all documents and papers having reference to the business of the Institute. In connection with the issues of such Bonds, there must be set aside out of the capital of the Institute a special Reserve Fund earmarked to secure such bonds equal to 20% of the principal amount of bonds issued. The aggregate amount of

[1] Articles of Association, Ch. III, para. 9.

[2] Law XXI of the year 1928 of Industrial Bonds, para. 3.

[3] Law XXI of the year 1928 on Industrial Bonds, para. 5.

the nominal value of the outstanding mortgage bonds should not exceed five times the amount of the Special Reserve Fund of that issue.[1] This fund must be invested in securities approved by the Government Commissioner and the Trustee for the Bondholders payable in the same currency as that of the bonds in respect of which such reserve has been created.[2] Besides this special Reserve Fund at least 10% of the annual net profits is to be carried to the ordinary reserve of the Institute. A portion of the remaining profits, not exceeding 5%, shall be applied to the benefit of the employees of the Institute. After all these deductions have been made, the balance is available for distribution as dividends, but in no circumstances dividends are to exceed a rate of 5% per annum on the paid up capital.[3]

The Institute grants loans on written application from industrial enterprises. The applicants must correctly answer the questions set forth in the prescribed application forms and must furnish all details regarding their financial position. They must also make a statement that they will allow the Institute to make full enquiries into their financial situation and will authorise the Institute and the Trustee of the Bondholders to examine the books, the way of carrying on their business as well as all circumstances connected with their finances.[4] Loans on first mortgages, securing the bond issues of the Institute, may only be granted provided that—

1. Tangible assets (exclusive of goodwill, patents, trade marks, etc.) so mortgaged by industrial enterprises are found to have a "basic value," by independent valuers employed by the Institute, of not less than three times the total amount of

[1] Articles of Association, Ch. III, paras. 10-11.

[2] Articles of Association, Ch. V, para. 35.

[3] Letter, dated 26th October, 1928, from the Chairman and Managing Director of the Institute to Messrs. Guaranty Company of New York. Also Ch. III, para. 10 of the Articles of Association.

[4] Articles of Association, Ch. X, para. 43.

the loan. The "basic value," which is the basis upon which loans are to be granted is estimated by careful computation and comparison of the book value, the going concern value and the break-up value in a forced sale of the borrowing concern.[1]

2. Quick assets of the borrowing enterprise cover the principal amount of mortgage loans as to 100% .

3. The borrowing industrial enterprise can satisfy the Institute that on the basis of its last ordinary closing account made up in the present gold currency of Hungary, available net profits, after due provision has been made for regular depreciation of plant, buildings and machinery, for bad and doubtful debts and taxes, have been sufficient for the preceding fiscal year to cover the annual interest and amortisation payable on the loan not less than three times, and after 1929, only if this result is shown on the mean net profits for the preceding three years.

4. The Board of Directors of the Institute are satisfied that there are no special reasons to anticipate that such profits will not be maintained in future.

5. No loan shall be granted when more than one Director objects thereto.

6. That in lieu of (2), (3) and (4), other appropriate full security, approved by the Government Commissioner, the Trustee for Bondholders and the Board of Directors of the Institute, is given for the mortgage debt as to both principal and interest.[2]

All mortgagars must maintain the conditions as set forth above and keep the mortgaged properties in first class working order and fully insured against damage by fire, acts of God or any other casualty and also against chomage (stoppage of

[1] Articles of Association, Ch. X, para. 44.

[2] Letter, dated October 26, 1928, from the Chairman and Managing Director of the Institute to Messrs. Guaranty Company of New York (Information issued by the Company.)

work). They are to permit the Institute, at any time when it or the Government Commissioner or the Trustee for the bondholders considers it necessary, to have an audit or revaluation of its assets made.[1]

The minimum loan that the Institute may grant must not be less than 10,000 pengos or the equivalent in the foreign currency thereof. The loan may be given either in ready money or in bonds issued by the Institute according to its option. The object of the Institute is not to make profits and declare very high dividends. Hence the rate of interest to be paid by debtor enterprises is not to exceed the rate of interest of the bonds to be issued on the basis of the loan. Besides this interest, they have to make a fixed contribution to cover the administration, management and other expenses of the Institute as determined by the Board of Directors in concurrence with the Government Commissioner.[2] They are also to make to the Institute semi-annual cumulative amortisation payments on their debt, calculated in accordance with a regular amortisation schedule, to repay such loans with interest by the date of the maturity of the Bonds in respect of which the mortgages were created.

A separate amortisation fund is to be created for each issue of first mortgage bonds out of the sums paid in by the debtors in accordance with the plan of amortisation on the title of principal, interest and annuity-instalments. The amortisation fund is to be kept quite separate and distinct and must be applied at the earliest date of payment in amortisation of the bonds of the Institute. Pending application in redemption of bonds, however, the fund may be temporarily invested with the approval of the Government Commissioner and of the Trustee for the bondholders in—

1 Articles of Association, Ch. III, para. 10.

2 Articles of Association, Ch. X para. 48.

(*a*) Buying fixed interest-bearing securities officially quoted on the stock exchange ;

(*b*) Advancing loans for a period of not more than 3 months on such securities up to the maximum of three-fourths of their market value quoted in the stock exchanges ;

(*c*) Discounting bills of exchange maturing within three months ; and

(*d*) Discounting above-mentioned securities and coupons thereof which have fallen due or will fall due within the next six months.[1]

The first mortgage bonds shall be redeemed at their face value in ready money within the term indicated on them by way of drawings, up to an amount not less than that corresponding to the amortisation in accordance with the sinking fund scheme of the mortgage loans. The Institute, however, is empowered to make at any time extraordinary drawings after having given previous notice thereof by advertisement.[2]

The mortgagors are entitled to repay their debt in advance of the regular amortisation schedule at any time. They may even be required by notice to pay in advance under the following circumstances[3] :—

(1) When the borrowers have been declared bankrupt;

(2) When they have failed to pay in due time all wages, salaries and other preferential liabilities;

(3) When they have failed to comply with their obligations under contract, inspite of intimation, within the term fixed;

(4) When, after the grant of the loan, it appears that the particulars which they put at the disposal of the Institute and

[1] Articles of Association, Ch. X para 51.
[2] Articles of Association, Ch. X, para. 52.
[3] Articles of Association, Ch. X, para. 46.

which served as the basis of the loan were inconsistent with the facts at the time of granting the loan;

(5) When, in the course of revaluation ordered by the Institute, it is found that the value of the assets mortgaged has undergone such changes that the claim of the Institute has discontinued in pursuance of the Articles of Association to be properly secured.

Payment of principal made voluntarily in advance of the regular schedule will be applied to redemption by purchasing bonds of this issue in the open market at prices not in excess of par plus accrued interest. If bonds are not available or when payments are not voluntary, such payments will be applied by additional drawings in respect of the sinking fund. All bonds redeemed are to be cancelled.

As regards the enforcement of its claims, the Institute enjoys special privileges. The law-courts are bound to issue, within three days of a notification by the Institute that a mortgagor has defaulted, authoritative decrees for the seizure of the assests of defaulting debtors and the sale thereof at auction.[1] Law XXI of 1928 provides that in case of default or when the claim seems to have discontinued to be properly secured in consequence of changes in financial conditions, the courts shall, on application from the Institute, direct appropriate measures for safety—among others, sequestration. The Institute may be appointed *sequestri curator*, if it so desires. The *sequestri curator* so appointed has the right to take possession of the enterprise and carry on its business until the legal procedure for the enforcement of the claim is completed.[2] Under the Law, the book entries and accounts signed on behalf of the Institute constitute legal proof.

The mortgages on properties and assets of the borrowing industrial enterprises, on the basis of which the first mortgage

1 Letter, dated 26th October, 1928, from the Chairman and Managing Director of the Institute to Messrs. Guaranty Trust Company of New York. (Information issued by the Company.)

2 Para. 18 of the Law XXI of 1928.

bonds are issued, are protected from the levy of any execution, even for public taxes and except in the case of compulsory winding up or bankruptcy, third persons cannot acquire any rights concerning them.[1]

The first bond issue of the Institute was an issue of $5,000,000 twenty-year First Mortgage Sinking Fund 7% Series 'A' gold dollar bonds. The bonds were in coupon form, in denomination of $1,000, and were dated November 1, 1928 They will mature on November 1, 1948. The interest is 7% per annum payable semi-annually on May 1 and November 1 of each year. The principal and interest are payable in gold coin of the United States, of or equal to the standard of weight and fineness existing on November 1, 1928, at the principal office of Guaranty Trust Company of New York or at the option of the holder at the office of the Institute in Budapest. No deduction for public charges or taxes existing or to be imposed hereafter is to be made from this interest.. The payment of principal and interest will be made alike in peace and war irrespective of the citizenship, nationality or residence of the holder.[2] The bonds were issued at 94 ¾%.

These $5,000,000 bonds constitute a direct obligation of the Institute and are secured according to the Articles of Association by—

(a) An equal aggregate principal amount of first mortgages on industrial enterprises ; and

(b) A special reserve fund amounting to 20% of the principal amount of series 'A' dollar bonds outstanding, to be invested in dollar securities approved by the Government Commissioner and the Trustee for the Bondholders.[3]

According to the report of the Board of Directors of the Institute for the first financial year, long-term industrial mortgage

[1] Articles of Association, Ch. II, para. 12, Also para. 17 of the Law XXI of 1928.

[2] Information issued by Messrs. Guaranty Company of New York.

[3] The various types of securities held in the Special Reserve Fund set aside to secure the first mortgage bonds outstanding are given in Appendix I.

loans were made, on the basis of this first bond issue of 5 million dollars, to the amount of $3,514,000 up to the 31st December, 1929. During the second financial year 1929-30 such loans advanced by the Institute amounted to $1,091,000. The total amount advanced during the two financial years thus amounted to $4,605,000. The sum of $395,000 which was still available for disposal was distributed in 1931. There was a large number of applications from industrial enterprises both in 1929 and 1930. The Institute could not act as promptly as it should have liked in the matter of granting the loans because it had to consider carefully the effects of the world-wide economic crisis which had set in.

The loans, completing the total $5,000,000 bond issue were distributed among the different branches of industry as follows [1] :—

		Dollars.
1.	Iron and Metal industries	916,000 (P 5,2,33,108)
2.	Chemical industries	559,000 (P 3,193,567)
3.	Woollen Cloth manufactories	614,000 (P 3,507,782)
4.	Other Textile factories	541,000 (P 3,090,733)
5.	Silk ware factories	463,000 (P 2,645,119)
6.	Printing and Publishing Co.	547,000 (P 3,125,011)
7.	China, Fayence and Brick manufactories.	204,000 (P 1, 165,452)
8.	Spirit distilleries	93,000 (P 531,309)
9.	Carpet weaving factories	97,000 (P 554,162)
10.	Paper mills	193,000 (P 1,102,609)
11.	Milling industries	383,000 (P 2,188,079)
12.	Oil refineries	88,000 (P 502,744)
13.	Brush manufactories	35,000 (P 199,955)
14.	Foodstuff factories	267,000 (P 1,525,370)
		$5,000,000 (P 28,565,000)

The task of the Institute does not end with the granting of the loans. For the protection of its interests it always

[1] Report of the Board of Directors of the National Hungarian Industrial Mortgage Institute, covering the second financial year from 31st December, 1929, till 31st December, 1930, Budapest, 1931.

keeps an anxious and critical watch over the financial position and management of the borrowing industrial enterprises. On the basis of the experience gained in this connexion, the Institute has proved to be of much useful service to its debtors in promoting their interests in various ways.

In estimating the financial results of the Institute's assistance, account must be taken of the effects of the prevailing economic depression upon every trade and industry. From the very second year of its existence, it had to carry on its activities under the shadow of the most wide-spread economic crisis the world has ever known. The gloom deepened more and more as years rolled on. Under the circumstances, the scope of its activities had to be considerably restricted. When it had completed the granting of the loans on its first bond issue, there could be no question of a fresh issue of bonds and of further granting of loans during the third financial year.[1] In consequence of the acute financial crisis, a number of the Institute's debtors also defaulted and became insolvent. There was one instance of insolvency during the first financial year, but as regards that the claims of the Institute happened to be fully secured.[2] During the next financial year, two factories became insolvent; but considering the great economic importance of these factories, the Institute, as *sequestri curator*, succeeded in maintaining them in operation after foreclosure.[3] One of these was an important textile factory. The smaller borrowers of the Institute became insolvent during 1930-31 and during the next financial year, four companies, three of which belonged to the iron and steel manufacturing group, defaulted and were put under foreclosure.[4] As

[1] Report of the Board of Directors, National Hungarian Industrial Mortgage Institute for the Third Financial Year (1930-31), Budapest, 1932.

[2] Report of the Board of Directors for the Second Financial Year (1929-30), Budapest, 1931.

[3] Report of the Board of Directors for the Third Financial Year (1930-31), Budapest, 1931.

[4] Report of the Board of Directors for the Fourth Financial Year (1931-32), Budapest, 1933.

regards the insolvency of the defaulted borrowers, the Institute believes that no loss will be incurred by it. The results of the liquidation of the assets of the companies under foreclosure and the collection of their outstanding claims tend to support this belief.[1] As regards other borrowers, only a very limited number of them have been in arrears with their amortisation instalments. The rest of the Institute's borrowers have regularly and punctually paid all interest and amortisation instalments and by the end of the fourth financial year closing on 31st December, 1932, the arrears in interest and amortisation payments due from borrowers became insignificant.[2] The difficulties of the borrowing enterprises have no doubt been very great but they were immensely benefited by the provision of the long-term industrial loans made by the Institute at a time when the need for them had never been greater. These loans must have enabled the industrial concerns to face with comparative strength the stress of the financial storm.[3]

As regards the profits of the Institute, it is found from a study of the Balance-Sheets and Profit and Loss accounts that its net profits amounted to pengo 66,746,08 in 1930, pengo 75,111,24 in 1931 and pengo 76,218,56 in 1932.[4]

III. The Provincial Mortgage Bank of Saxony[5]

The Industrial Mortgage Bank of Finland, Ltd., is an example of a private jointstock company without any participation by the State in its share capital. The National Hungarian Industrial Mortgage Institute is a jointstock company, the major portion of whose capital has been subscribed by the State. The Provincial

1 Report of the Board of Directors for the Fourth Financial Year (1931-32), Budapest, 1933.

2 *Ibid.*

3 Report for the Third Financial Year (1930-31), Budapest, 1932. Also Report for the Fourth Financial Year (1931-32), Budapest, 1933.

4 Balance-Sheets and Profit and Loss accounts of the National Hungarian Industrial Mortgage Institute for the years ending 31st December, 1930, 1931 and 1932.

5 The sources are all in German. The necessary documents were obtained from the authorities of the Bank in Dresden, Saxony.

Mortgage Bank of Saxony is to be distinguished from these two types in that it is a State institution whose entire foundation capital of 1 million RM. has been contributed by the Government. The Bank came into existence on 1st October, 1925, in accordance with the Law of July 20, 1925. Truly speaking, it is an annexe of the State Bank of Saxony. The premises were supplied by the State Bank and the personnel was also taken from it.[1] According to the business regulations all payments for the Bank are to be deposited with the State Bank of Saxony. All payments of the Bank to the borrowers have also to be placed with the same institution. The business of the Directorium of the Bank, according to Sec. 12 of the statute relating to its establishment, is made over to the Directorium of the State Bank, which in connexion with the business of this institution signs as "Provincial Mortgage Bank of Saxony." The juridical officials of the State Bank are also its officers. The State Bank gets adequately paid for the management of its business, the rate of payment being fixed by the Minister of Finance.

The Provincial Mortgage Bank of Saxony has its seat in Dresden. Its object is to promote real credits for industry, trade and handicrafts in the free State of Saxony.[2] It obtains the necessary funds for making the loans by issuing interest-bearing bonds. Bonds are divided in series, each series maintaining its special amortisation and reserve funds.[3] The sum total of circulating bonds must not exceed 75 million RM.; and they must be covered to the extent of their nominal value by mortgages of at least the same value and bearing at least the same amount of interest.[4] The institution is responsible for the bonds with all its property.

[1] Business Report of the Provincial Mortgage Bank of Saxony for the year 1925. (Bericht Sachsischen Landespfandbriefanstalt Uber Das Geschaftsjahr, 1925.)

[2] Statutes relating to the establishment of a Provincial Mortgage Bank of Saxony, July 20, 1925, Sec. 2.

[3] *Ibid.*, Sec. 5 (1) and (2).

[4] *Ibid.*, Sec. 6 (1).

Loans are furnished on mortgage of industrial and commercial real estate to industry, trade and craft. Other real estate connected with the former in business way can also serve as the basis for loans, provided it belongs to the self-same owner. Not more than 30% of the value of the real estate is to be taken into *consideration in granting a loan. This value has to be estimated* according to the sale as well as the income possibilities.

Lands lying in Saxony can be mortgaged even when they are not used directly for professional purposes, provided they are used for residential purposes by the credit seeker. Loans may be granted up to 50% of the estimated value of such lands. These rules are to be applied only when the mortgage is valued at 20,000 RM.[1]

The loans can be made either in cash or in bonds. They are made against mortgages without reference to other securities, and can be withdrawn at a date earlier than that fixed, except when so laid down in the contract. Besides the mortgaged property, the bonds issued by the Bank enjoy an additional security. Every credit seeker is jointly and severally liable up to 10% of the loan granted.[2]

The application for a loan must be made in a form of the Bank given for the purpose which should be fully and correctly filled up by the credit seeker. Along with this application the borrower must furnish the three latest balance-sheets, profit and loss accounts, an interim balance-sheet if necessary, abstracts from the grundbuch, the latest information about the property tax, insurance policies for the machines and all other inventories, etc. The borrower must allow the Bank to examine all his properties. The Bank can even have the latest balance-sheets examined by the State Bank of Saxony at the expense of the borrower and can also have the lands (property and inventory) appraised by an expert.

1 Statutes relating to the establishment of a Provincial Mortgage Bank of Saxony, Sec. 8 (1), (2) and (3).

2 *Ibid.*, Sec. 9 (1), (2) and (3).

Until the loan has been paid back, the credit seeker is obliged to submit continually every year without demand the balance-sheet with the profit and loss account within three months after the close of the business year. If the Bank so desires, it can demand the interim balance-sheet also and can get all the books and documents of the borrower examined by the State Bank of Saxony. In regard to loans above 50,000 GM. the balance-sheets must be signed by an auditor or trust company approved by the Bank.[1]

The loan is made in fine gold (1 gm. is equal to $\frac{1}{2790}$ Kgm. of fine gold) in RM. or in foreign currency; and it will be based on the issue of bonds worth the value of the nominal loan. The bonds can be cashed either through the Bank at the cost of the borrower or can be made over to the borrower on a basis of mutual understanding. The bonds, then, are not to be cashed completely or partially before a certain period.

The bonds are divided in series. The rates of interest and the method of payment follow the rules of every series of the loan. The borrower has to pay an annuity to the Bank every year in equal half-yearly instalments. This annuity comprises of interest, amortisation and risk of $\frac{1}{4}$% per year.[2] The Bank is also entitled to receive a sum for administrative expenses. An additional payment is demanded in case of unpunctual payment of the regular quotas. The loan bears interest from the moment of issue. The interest will have to be paid for the same period for which the bonds also have to bear interest. The borrower, however, has to pay his interest, etc., forty-five days before the due date for the payment of the interest on bonds. If the borrower happens to be more than eight days in arrears in regard to the payment of interest, etc.,

[1] Business regulations of the Provincial Mortgage Bank of Saxony, Art. 1.
[2] *Ibid.*, Art. 3.

the interest rises automatically up to 2% of the original loan excluding special repayments, in every case at least up to the legal rate of interest. At the same time the interest for the remaining amounts will have to be paid at the same rate.[1]

The loan can be terminated from the side of the borrower on three months' notice. From the side of the Bank it can be terminated under the following circumstances [2]:—

(1) If, after the loan has been made, it is found out that there are some discrepancies between the data presented by the borrower in his application for the loan and the actual facts relating to the property, etc.;

(2) If the debtor fails to satisfy the contract;

(3) If certain portions of the mortgaged land are separated, without the permission of the Bank;

(4) If the title holder or possessor of the mortgaged land does not hold himself responsible for the debt;

(5) If it so appears that the possessor of the mortgaged land cannot be fixed upon as a personal borrower;

(6) If the insurance policies are not renewed and the premiums are not paid;

(7) If the borrower becomes insolvent and the mortgaged lands are placed on auction;

(8) If the machines or other tools and implements which are essential for the value of the real estate are destroyed or removed from the land and are not replaced; or if nothing is done to reconstruct or repair the land or if for any other reason the land diminishes by more than 20% in value, and if the borrower does not try to make amends for the loss in other ways;

(9) Otherwise, whenever it is necessary for the Bank to demand the withdrawal of the loan for reasons of security.

1 Business Regulations, Art. 6.

2 *Ibid.*, Art. 6.

The Credit Committee, in conjunction with the State Commissar, is to decide whether there is a real danger.

The Bank has the right to cover its loans with bonds in case the borrower does not pay punctually and can demand of him the necessary costs. In addition to the amortisation and interest, etc., the borrower must pay the Bank up to 10% of the loan whenever the bonds fail to reach the desired amount in order that the responsibilities of the Bank in connection with the bonds may be discharged.[1] The State Commissar fixes the quota under such circumstances. Further payments can be demanded if necessary until the sum mortgaged is realised. The obligation to make additional payments ends one year after the complete repayment of the loan, unless in the mean time the borrower is absolved of the responsibilities. The responsibility for amortisation and interest and additional payments is to be assured by bonds. For all these claims which are not assured by bonds, a new security rising up to 10% of the loan is to be deposited. As in the case of the Finnish and Hungarian institutions, the borrowers of the Saxon Mortgage Bank must have the buildings together with the installations, tools and implements, raw materials and other goods insured against damage by fire or otherwise with an insurance company approved by the Bank and must keep them insured during the entire period of the loan. The Bank can get these insurance documents examined by its own experts. It has the right to the sums insured. If it so desires, the payment of premiums is to be notified to it. The mortgage of the Bank is to be secured in every way by notice to the insurance company. The company's certificate in regard to the insurance of the mortgage has to be handed over to the Bank. The Bank has the further right of paying premiums and of making new insurance at the cost of the borrower.[2] If a life policy is an additional security according to the terms of the loan to be offered by the Bank,

[1] Business Regulations, Art. 9.

[2] *Ibid.*, Art. 12.

the policy is to be taken with an insurance company recommended by the Bank on the condition that the sum assured is to be paid to itself. The sum assured serves as the security of the obligations of the borrower and is to be deposited by the Bank with the State Bank of Saxony. The premiums may have to be placed with the Bank, if it so desires, in order that they may be made over to the insurance company punctually. The Bank, as before, has also the right to pay the premiums at the cost of the borrower. [1]

As long as the loan is not paid back, none of the important parts of the installations or accessories can be mortgaged or sold without the permission of the Bank. Whenever any mortgage is made, the Bank must be notified at once.[2]

The organs of the Bank are—

(1) The Directorium;
(2) The Administrative Council; and
(3) The Committee of Credit.

The Directorium is responsible for the administration, business management and judicial and extra-judicial representation of the Bank. It is, in all the interests of the Bank, the principal authority in so far as nothing otherwise is mentioned in the Act. The business of the Directorium has, as already noted, been transferred to the Directorium of the State Bank of Saxony. [3]

A Credit Committee is to be formed in the jurisdiction of every Chamber of Commerce. The Committee is to consist of a member of the local Chamber of Commerce as President, a member of the local Chamber of Business (Gewerbe) and at least three other members. All the members of the Credit Committee are appointed for two years by the Directorium with the approval

1 Business Regulations, Art. 14.
2 *Ibid.*, Art. 13.
3 Statutes relating to the establishment of the Ban , Sec. 12 (1) and (2).

of the State Commissar. The Credit Committees are to be of help to the Directorium for the affairs of their jurisdiction specially in regard to the demands for credit. The Directorium should not go beyond the amounts of credit recommended by the Credit Committees.[1]

The Administrative Council is composed of the State Commissar, the Vice-President and 12 other members at the highest. Three members are appointed by the Landtag for two years. The five local Credit Committees send each one a member to the Council. These five members are appointed by the Minister of Finance on the recommendation of Credit Committees. At least two of these members must come from the Chambers of Commerce and at least one from the Industry and Trade Chambers. The other members are appointed from among the credit seekers on the recommendation of the Chambers of Commerce and Industry by the Minister of Finance and the Minister of Economic Development. The Administrative Council has the power to supervise the business management of the Directorium; and with this object in view it can demand information in regard to all business affairs and examine the books and documents or get them examined by others. It can also study the position of the bonds, mortgages, securities, etc., and can be present while the auditing of accounts is being carried on. While engaged in these examinations, the Administrative Council may draw upon the Revision Department of the State Bank of Saxony. It is also to be heard in regard to the specially important and fundamental affairs, for instance, interest, amortisation and other rates, the principles of granting credit, the sale and purchase of lands, the expansion of the sphere of business, etc. If a majority in the Administrative Council reject the suggestions of the Directorium, the decision of the Minister of Finance is to be appealed for by the State Commissar. The preparation

[1] Sec. 15 of the Statutes relating to the establishment of a Provincial Mortgage Bank of Saxony, July 20, 1925.

of the yearly accounts rests with the Administrative Council. If the State Commissar raises objections against the statement of accounts presented by the Administrative Council, the Minister of Finance, again, is to be appealed to.[1]

The Minister of Finance is the supervising authority. He is empowered to undertake all measures that may be required to govern the Institution in accordance with loans and regulations. He has to decide in regard to all personal and national differences that may arise among the members of the Directorium on whom his decisions are binding. He exercises his power of supervision and control through the State Commissar or his representative appointed for the State Bank of Saxony. The State Commissar is authorised to undertake any measure necessary to keep him informed about the Institution. For instance, he is authorised to inspect all books and documents at any time, to examine the entire business management and administration, to demand information, to attend revisions or cause them to be undertaken and to take part in the meetings of the Directorium and Credit Committees or cause such meetings to be held. He should also see that the rules for cover in regard to bonds as well as the systematic amortisation of hypothecs and bonds are carried out.[2]

As regards the Reserve Fund, it should be mentioned that in addition to the general Reserve, there is also a special Reserve for each series of the loan, called the series Reserve. Twenty-five per cent. of the net profits is to be placed in the general Reserve until the Reserve reaches twenty per cent. of the bonds. After that the deposit of the Government is to be furnished with interest at the average Reichsbank rate. The rest will have to be used either for strengthening the amortisation fund or otherwise in the interest of the borrower.[3] Provision

[1] Statutes relating to the establishment of a Provincial Mortgage Bank of Saxony, July 20, 1925, Sec. 14.

[2] *Ibid.*, Sec. 16.

[3] *Ibid.*, Sec. 19 (1), (2) & (3).

for risk is to be added to the Reserve as soon as 5% of the capital is reached ; the rest is to be added to the amortisation fund.[1]

In case of liquidation, the State Bank of Saxony will supervise operations. In case any property is left after amortisation of bonds and fulfilment of other responsibilities including the repayment of the State deposit, it passes over to the Government for employment for similar purposes.[2]

The preparatory work for bringing into existence the Mortgage Bank and its organisation was completed in the last three months of the year 1925. Actual business could be undertaken during the first months of 1926. The whole German economic position was shaken by a severe crisis at the time. Many firms which came into existence during the inflation period had to go into liquidation ; and they took with them many others as they fell. There was the competition of foreign countries with highly inflated currencies. Already there was want of liquid capital in Germany. During the inflation period the different industrial undertakings had invested their capital in construction. After the return to stabilization, acute competition again made its appearance, and new investments were urgently called for to reorganise old factories and adapt them to new methods and new conditions. There arose an enormous demand for long-term credit. The undertakings could not without grave risks help themselves with short-term credit. Under the circumstances it was strongly recognised that an institution whose business would be to give long-term amortisation loans on mortgage to industry must be of great economic value to the country.[3] As soon as the Saxon Mortgage Bank was established, it came to be utilised by wide circles of industry, commerce and handicrafts of Saxony.[4] This also amply proves

1 Statutes relating to the establishment of a Provincial Mortgage Bank, July 20, 1925, Sec. 9.

2 *Ibid.*, Sec. 21.

3 Business Report of the Provincial Mortgage Bank of Saxony for the year 1926.

4 *Ibid.*, for the year 1925.

the importance of establishing such a type of institution to meet the pressing demands for long-term loans from these circles.

During the first three months of the existence of the Bank, want of capital stood in the way of its extending large facilities to industry. It was felt that the enormous capital required for the purpose could not be successfully raised in the local capital market. Accordingly an attempt was made to tap the foreign market. Even before the Institute was functioning, negotiations had been opened by the State Bank of Saxony with a leading American institution, the National City Company of New York, for the purpose of raising a loan. The negotiations lasted for four months and were finally concluded in January, 1926, with the result that the American Company agreed to furnish a 7% mortgage loan to the extent of 5 million dollars. This loan enabled the Institute to issue loans of the nominal value of 21 million gold marks, bearing interest at 8% and redeemable in 20 years in uniform annuities of 10·356%.[1]

In anticipation of this capital from America, the first three months of the Bank's existence were devoted to the examination of the numerous applications for loans received by it. The examination was carried on with great care. The credit-worthiness of the applicants, the sale and balance sheets, the soundness of the firms were minutely examined. It was also necessary to form an idea of the basis of the firm taking the loan whether the undertaking was likely to fail or not according to the constitution, nature and position of the business and whether it had the sure prospect of at least paying the interest and amortisation.

During 1926, 1,000 applications were granted. Credits over 20,000 gm. were granted only after special consultation with other representatives of Industry, Trade and Craft ; those of 100,000 gm. or over were given only after permission of the State Commissar was obtained; and those over 200,000 gm. after permission of the Ministry of Finance and the Admini-

1 Business Report of the Provincial Mortgage Bank of Saxony for the year 1925.

strative Council.[1] The industries that were chiefly assisted were the textile and metal industries of Saxony.[2] In 1928 the foreign market for raising the bond loans of the Institute was closed and the internal market had to be resorted to. In the spring of 1928 Series V Bonds of 5 million gm. at 8% and Series VI Bonds of 5 million gm. at 8% were issued at 98% and 97½% respectively.[3] Every size and every branch of business was assisted and every part of the country (Saxony) was represented. As before, the chief industry to be assisted was the textile industry. The year 1930 witnessed a crisis in German economy the like of which had never been known before; and as a consequence, the middling and smaller industries came to experience great difficulties. The demand for industrial mortgage loans was very great but only a part could be satisfied. Among the borrowers were to be found the most diverse sizes of business and practically every branch of industry located in Saxony was represented. In the next year (1931) there were numerous applications for loans from industrial concerns of various kinds and sizes. The Bank found it possible to accommodate several industrial and commercial enterprises. The amount of 2,037,000 RM. was placed at the disposal of industry and commerce. An analysis of the loans granted in the year shows that[4] :—

34·7 % of the loans were up to 20,000 gm.
28·2 % of the loans were from more than 20,000 gm. up to 50,000 gm.
18·2% of the loans were from more than 50,000 gm. up to 100,000 gm.
18·9% of the loans were above 100,000 gm.

The prevailing economic crisis, however, prevented further development of the Bank's business. The sale of bonds was

[1] Business Report of the Provincial Mortgage Bank of Saxony for the year 1926.
[2] *Ibid.*, for the year 1927.
[3] *Ibid.*, for the year 1928.
[4] *Ibid.*, for the year 1931.

well as the issue of loans on acceptable terms became difficult. The borrowers of the Bank were also severely affected. During 1932 the crisis continued to affect unfavourably the transactions of the Bank in many directions. The issue of the loans came to a standstill and the insecure economic conditions of the year did not permit the grant of long-period credit to industry. The borrowers of the Bank, the industrialists and craftsmen of Saxony, were struggling for their very existence during the year.[1]

Inspite of the fact that on account of the crisis, the export trade was paralysed and the industries of Saxony were in great difficulties, the situation experienced a turn towards recovery in the year 1933. The number of borrowers of the Bank who were in trouble became less in 1933 than in the previous year. The issue business, however, continued to remain almost at a standstill.[2] It was understood that as soon as the economic situation would permit, the Bank would not fail to accommodate the industries of Saxony with long-period credit.[3]

As regards the question whether the financial results of the Bank's policy have been successful, it may be mentioned that its loans have in almost every case been well-covered ; and the number of defaulting borrowers has never been very great. A careful perusal of the annual Business Reports of the Bank from 1925 to 1933 shows that it has not suffered any loss. This is stressed over and over again in almost all the Reports. Even during the severe crisis of 1930, the majority of the borrowers are found to have punctually fulfilled their obligations and there was no loss in any case.[4] During 1931 and 1932 as the crisis became more and more acute, the borrowers of the Bank began to experience greater difficulties but as before there were no

1 Business Report of the Provincial Mortgage Bank of Saxony for the year 1932.
2 *Ibid.*, for the year 1933.
3 *Ibid.*, for the year 1931.
4 *Ibid.*, for the year 1930.

losses. This must be due to the general caution with which the Bank always distributed its loans. No assistance was ever granted to any firm which was badly involved or whose recovery was doubtful. For example, many firms subject to very unfavourable business conditions which had approached the Bank for assistance in 1929 were refused any help. The Directors emphasise in their Report that the Bank does not want to leave any doubt that it is not a "welfare institution."[1]

Inspite of the most careful selection of borrowers, however, it could not be prevented that some of them fell into trouble and became defaulters. But the number of delinquents in every year was very small; and because of the very careful valuation of the mortgages, the claims of the Bank in almost all cases were satisfied. In 1928, for example, only 6 out of 576 borrowers became bankrupt.[2] As the depression deepened, the number of defaulters began to increase and it was naturally higher in 1931 than in the previous year. The number of compulsory auctions undertaken by the Bank was also greater than in the previous year but the Directors' Report emphasises that there was no loss in any case.[3] But with the year 1933, the situation considerably improved and the number of borrowers in trouble, as already noted, was less in 1933 than in 1932. There were in this year (1933) compulsory auctions in 14 cases only.[4]

From the preceding discussion, it is clear that the Bank's record is quite a happy one. The institution weathered the financial storm very successfully and indeed it is highly creditable that it has not suffered any losses, although the crisis severely affected its industrial customers. The success with which the Bank has generally carried on its operations even in the midst of the most severe crisis Germany has ever known amply demonstrates the practical value of the development of such institutions.

[1] Business Report of the Provincial Mortgage Bank of Saxony for the year 1929.

[2] *Ibid.*, for the year 1928.

[3] *Ibid.*, for the year 1931.

[4] *Ibid.*, for the year 1933.

As the Directors of the Bank have remarked in its Business Reports, "Days like those of 1930 are real touchstones for the correctness of the views according to which the Bank was established."[1]

The position of the bonds issued and outstanding on the 31st December, 1933, is indicated in the following table[2]:—

			Outstanding.
1.	7% U.S.A. $ Bonds	$ 5,000,000—	$ 1,780,000
2.	6%(8%) GM. Pfandbriefe Serie II	GM. 5,000,000—	GM. 3,992,200
3.	6½% U.S.A. $ Bonds	$ 4,000,000—	$ 1,553,000
4.	6% U.S.A. $ Bonds	$ 2,000,000—	$ 890,000
5.	6%(8%) GM. Pfandbriefe Serie V	GM. 5,000,000—	GM. 4,159,400
6.	6%(8%) GM. Pfandbriefe Serie VI	GM. 6,000,000—	GM. 5,218,300
7.	6%(8%) GM. Pfandbriefe Serie VII	GM. 3,875,550—	GM. 3,572,600
8.	6%(7%) GM. Pfandbriefe Serie VIII	GM. 7,000,000—	GM. 6,477,300

IV. The National Economic Bank of Poland[3]

The National Economic Bank, or Bank Gospodarstwa Krajowego as it is called, was established in 1924 by virtue of an order of the President of the Republic, dated 30th May, 1924, as the result of a fusion of three Polish State Credit Institutions, the Polish National Bank, the State Bank for Reconstruction and the Credit Institution of Galician towns. The capital of the Bank, as defined by the statutes, may consist of shares held by the State Treasury, by the undertakings of the State and of Local Government authorities, by the authorities of Palatinates, counties and unions of independent towns, not subordinate to counties

1 Business Report of the Provincial Mortgage Bank of Saxony, for the year 1930.

2 Sachische Landespfandbriefanstalt Bilanz fur den 31st Dezember, 1933.

3 All the necessary literature was secured from the authorities of the National Economic Bank, Warsaw, with the assistance of Mr. E. Banasinski, Consul for Poland in India.

and by all undertakings belonging to these local authorities. The proportion of the capital to be held by the Treasury and State undertakings may not be less than 60%.[1] It was originally started with a capital of 35,000,000 zlotys. This was subsequently increased to 120,000,000 zlotys in 1927 and again to 150,000,000 zlotys in 1928. Until now the entire capital of the Bank has been owned by the State. It is a State institution called into being at a time of crisis in order to reconstruct the economic life of Poland; and its financial sphere of action embraces every branch of Polish economic life.

The authorities of the Bank are the President of the Bank, the Administrative Council and the Managing Committee. The President is appointed by the President of the Republic on the proposal of the Council of Ministers for a term of 5 years. He has supreme control over the entire activity of the Bank. The Administrative Council consists of the chairman and of nine to fifteen members appointed for 3 years. The Minister of Finance appoints nine members and the remaining six are appointed by Local Government authorities or their Unions according to their declarations as to the amounts contributed by them towards the capital of the Bank within the limits of their maximum permissible holdings. As the Treasury holds the entire capital, the Council at present consists of nine members appointed by the Finance Minister only. The functions of the Council consist in the general direction of the activities of the Bank and the supervision of the work of its executive agencies. The Council is empowered to decide on all matters not reserved for the decision of the Finance Minister. The ultimate control of the Bank is vested in him; and he has the right to appoint a Government Commissioner to represent him.[2] It is the duty of the Commissioner to participate in the meetings of the Administrative Council in an advisory capacity, to check the regularity of the activities

[1] Charter of the National Economic Bank, Art. 4. Warsaw, 1930.
[2] *Ibid.*, Art. 20.

of the Bank in respect of long-term credits and to control the issues of mortgage bonds and debentures to the limits laid down by the laws.[1] The Managing Committee is made up of one General Manager, two Assistant General Managers and Managers. They are all elected by the Council and approved by the Finance Minister. The Managing Committee conducts all the business of the Bank, represents the Bank in its dealings with third parties and administers its property.[2] The members of the Managing Committee may attend the meetings of the Administrative Council in a consultative capacity.[3] Besides these authorities, there are three auxiliary agencies of the Bank, *viz.*, the Auditing Committee, the Discount Committees at the Head and Branch offices and the Committee for matters relating to autonomous authorities and Savings Banks.[4]

The basic function of the National Economic Bank is the provision of long-term credits. The various kinds of long-term credits that the Bank is empowered to grant are mortgage, communal, railway and industrial loans, repayable in instalments or in one payment, in mortgage bonds or debentures or in cash. Mortgage bond loans are chiefly granted on land estates, urban immovable properties and for the conversion of cash building loans. Communal loans are granted against communal debentures to State and Local Government authorities, water boards and public legal institutions having the right to levy taxes. Railway loans are given by means of railway debentures to State and Local Government authorities and their Unions, towns and private railway undertakings against the security of a mortgage on their railways. Industrial loans are given by means of bank debentures. These bonds and debentures may be placed both at home and abroad and may be made out in zlotys, gold

1 Statutes of the National Economic Bank, Para. 102. The remuneration of the Commissioner is paid from the funds of the Bank.

2 Statutes of the National Economic Bank. Para. 88.

3 *Ibid.*, Para. 91.

4 *Ibid.*, Para. 93-97.

or foreign currencies. They carry a guarantee of the Treasury of the Republic of Poland. The mortgage bonds are guaranteed to an unlimited extent, communal debentures up to 500 million gold zlotys, railway debentures up to 20 million and bank debentures placed in foreign markets up to 100 million.[1] The duty of the Bank consists further in the promotion of financial institutions, founded by Local Government authorities (Savings and Communal banks), the fostering of building activity and the reconstruction of the devastated areas of Poland.[2] Although the main object of its activities is the provision of long-term credit, they are not confined to it exclusively but comprise the granting of short and middle-term credits as well. Besides, the Bank conducts every description of banking business, having special regard to the needs of State and State undertakings and Local Government authorities and their undertakings. It accepts deposits on cheque and current accounts and on Savings books ; it discounts bills of exchange and grants fixed loans and credits on current accounts on various kinds of securities, purchases and sells bills of exchange, issues drafts and accepts deposits of securities, documents and jewels.[3]

The net profits of the Bank are to be divided as follows :—

(1) Special reserve funds are to be created out of 35% of the net profits for the purpose of securing the mortgage bonds and debentures issued by the Bank in proportion to the respective issues ;

(2) another reserve fund from 40% of the net profits to be equally divided among the various branches of the Bank ;

(3) and the remaining 25% is to be distributed among the Government and local authorities in proportion to their share holdings.[4]

[1] Decrees of the President of the Republic, dated 17th September, 1926 and 30th December, 1924.

[2] Charter of the National Economic Bank, Arts. 5.8; Statutes of the Bank, Paras. 5, 14, 18, 38, 48 and 50.

[3] Statutes of the National Economic Bank, Para. 63.

[4] *Ibid.*, Para. 74.

The sources of funds for the operation of the Bank are four-fold :—

(1) The Bank's own capital and reserves,

(2) the proceeds of the bond and debenture issues,

(3) deposits and

(4) Treasury funds.

The long-term credits are mainly based on the mortgage bonds and debentures ; while the short-term credits are based upon the deposits accepted by the Bank. It receives deposits both from public and private institutions as well as individuals. They are made up of sight (cheque and current account) and savings deposits, as well as term-deposits. Besides deposits, the Bank administers a large volume of Treasury funds which are destined for various purposes. These funds comprise mainly the State Building Fund from which loans are advanced at a low rate of interest for the construction of dwelling houses. The credits furnished from the Treasury fund assume chiefly the nature of medium and long-term credits and only partially that of short-term credits.

As already noted, the activities of the National Economic Bank extend to every sphere of the country's economic life. We are interested only in its relations to industry and we shall confine our attention exclusively to its activities in that sphere. Its operations in the mortgage, railway, municipal, building and reconstruction branches are no doubt highly important ; but a review of these activities does not fall within the strict limits of our study. We shall therefore proceed to make a detailed survey only of its industrial financing activities. The relations of the Bank towards industry are of a two-fold character, first, its relations towards industrial enterprises belonging to the State and the Bank itself and secondly, its relations to private industrial undertakings. As regards State and associated undertakings, the duty of the Bank consists in placing them on a sound financial

footing, maintaining at the same time their commercial character. The assistance granted to these undertakings takes the form of (1) provision of initial capital, (2) granting of working capital, (3) and allocation of investment funds, when required, in the shape of long-term mortgage credits in bank debentures. Apart from this, the Bank is particularly interested in the rationalisation of industrial concerns and the concentration of their production.[1] Financial assistance granted to private industry by the Bank has also been expressed in the same three forms. Industrial credits granted by the Bank are thus both long- and short-term. The former are granted either in the form of debenture loans or cash loans. The latter which are for working capital purposes take the shape of discount, time or goods credits and of over-drafts on current account.

The right to participate in industrial undertakings was conferred upon the Bank by Art. 11 of its charter. The provisions of this Article empowered the Bank to establish, to conduct or to act as intermediary in the formation of undertakings, provided that they were the property of the State, Local Government authorities, corporations having the power to levy taxes for their own requirements as well as of private concerns, the establishment or holdings of shares in which were deemed necessary by the Minister of Finance in conjunction with the Ministers concerned.

The activities of the National Economic Bank in respect of the provision of industrial loans have been directed, ever since its establishment, chiefly towards the financial assistance of industrial undertakings which are of economic importance to the country as a whole, and to those economic organisations in the existence and development of which the Government had a special

[1] *The Activity of the National Economic Bank in its relation to the economic situation in Poland in 1927.* Exposé of Dr. Roman Gorecki, Chairman of the Bank, at the Press Conference held on 24th February, 1928, p. 22.

interest. Hence the enterprises which have enjoyed primary consideration in the matter of financial assistance are those connected with the chemical, metallurgical and electrical industries. Owing to the conditions under which the economic life of Poland developed during the first years of the existence of the Bank, it could not confine its activities exclusively to satisfying the financial requirements of State undertakings. During the inflation period and the subsequent prolonged depression, numerous private industrial undertakings badly suffered from lack of credit facilities. Unable to obtain financial accommodation from the ordinary channels, they were compelled to seek assistance from outside. The supply of foreign capital available, however was too inadequate to satisfy their requirements and hence it became necessary for them to invoke the assistance of the State. The National Economic Bank, being the institution specially called into being to carry out the Government's intentions regarding the reconstruction of the economic life of the country, had to take upon itself the task of providing finance for these struggling industries. Long-term cash credits were liberally granted to numerous undertakings during this period so as to help them to pull themselves out of the economic morass.[1]

On the termination of the crisis, again, these began to require large volumes of permanent capital to carry on costly schemes for developing, modernising and re-equipping their factories to keep themselves abreast of the times and to adapt their production to the increasing requirements and altered demands of the market. They had to make fresh issues of share capital. But as most of them were unable to obtain the necessary funds from the investing public, they sought again the assistance of the Bank. Accordingly the Bank had to take over large parcels of shares to retain them in its portfolio until the industries concerned were able to obtain sufficient financial assistance from the

1 Report of the Directors, National Economic Bank, for the financial year 1927, Warsaw, 1 28, p. 28.

public. Under the circumstances the holdings of the Bank in industrial undertakings have not been insignificant.[1]

Applications from industrial concerns for long-term credits in the form of bank debentures are subjected to the closest scrutiny as regards their financial and technical soundness. No assistance is ever granted to schemes, the object of which is to bolster up enterprises of an unsound character. Finance is always readily granted wherever a particular tendency towards concentration is noticeable. Before granting any long-term credit in this form, the Bank in each case takes the opinion of the relevant Trade Association and also obtains the view of the competent Chamber of Commerce. Such expressions of opinion, though naturally not binding on the decision of the Bank, materially assist it in judging whether the credit granted will be employed for production purposes.[2]

The general principles to be followed for the granting of long-term industrial loans against bank debentures are laid down in Paras. 50-60 of the statutes. Such loans may be granted on industrial properties, sea and river-going vessels and factory buildings provided they can be easily converted into dwelling houses or for the use of such industry as has in the opinion of the experts definite prospects for development in that district. The amount of loan should not exceed half of the appraised value of the land, two-fifths of that of the buildings and one-third of that of the plant definitely required for the running of the industrial undertaking and permanently attached to the real property. If water-power forms a portion of the industrial real property, a loan may be granted up to one-third of its estimated value. But theatres, mines and quarries will not serve as a guarantee for a loan in debentures. The assessment of the value of buildings and permanent factory equipment will be done on the basis of their actual value after making allowances for any possible

[1] Report of the Directors, National Economic Bank, for the financial year 1928, Warsaw, 1929, pp. 91-22.

[2] Exposè of Dr. Roman Gorecki, Chairman of the Bank, at the Press Conference held on the 24th February, 1928, Warsaw.

depreciation in case of the liquidation of the industrial undertaking.[1] Industrial loans are to be secured by a mortgage on the property on which the undertaking is situated and to increase the security may be further secured on other real properties.[2]

The Bank may issue bank debentures on the basis and up to the amount of industrial loans granted. It may also issue such debentures secured by mortgage bonds and debentures issued by Polish long-term credit institutions and for Local Government authorities which bear the guarantee of the State. These bank debentures are issued to bearer with a guarantee of the repayment of interest and capital on the conditions set forth in them. The total of the debentures in circulation is not to exceed the total amount of industrial obligations held by the Bank at the same time.[3]

The mortgages on industrial real estate, designated for the securing of loans granted in bank debentures, constitute a separate portion of the assets of the Institution, set aside to secure the rights of the holders of both future and past issues of debentures.[4] The payment of capital and interest to the debenture holders is guaranteed not only by the industrial obligations that the Bank may hold but by its entire assets. To ensure the regular payment of the half-yearly coupons on the debentures, a special reserve fund is built up, which is made up of the following[5] :—

(1) Registration fees paid at the time of receiving an industrial loan from the Bank amounting to 1% of its nominal value ;

(2) Profits from purchase of debentures for cancellation ;

(3) Special Reserve Fund for industrial and other loans set aside from the net profits ;

1 Statutes of the National Economic Bank, Para. 56.
2 *Ibid.*, Para. 59.
3 *Ibid.*, Para. 15.
4 *Ibid.*, Para. 13.
5 *Ibid.*, Para. 17.

(4) Profits obtained from lapsed coupons and drawn debentures.

The rate of interest payable on the debentures is to be always equal to that of the loans, on the basis of which the respective debentures have been issued. The borrowed funds may be repaid to the Bank either in instalments as fixed by an amortisation scheme or in one single payment. All such repayments should be credited to the sinking fund for the redemption of the debentures, which must be drawn by lot and repaid at par.[1] The debtor may repay the loan either partially or in full before the fixed term, provided that the partial repayment is equal to one or more of the instalments due from him and that he gives notice of his intention to do so at least six months before the next instalment falls due.[2]

The borrowers have to pay the stipulated instalments constituting payments of interest and capital in advance at the fixed dates and besides a supplementary charge as contribution to the expenses of administration. The rate of interest payable on the loans and the amount to be paid for administrative charges will be fixed by the Administrative Council, subject to the confirmation of the Minister of Finance.[3] They have to insure the industrial properties, on the security of which they receive a loan from the Bank, against fire, with an institution designated by the Minister of Finance. Any sums payable to the insurer under the policy must not be paid without the Bank's permission.[4]

The Bank has the right to suspend the payment of the loan if the applicant dies or becomes bankrupt or if he fails to apply for the loan within 30 days from the date of the receipt of a notification that the loan is ready to be paid over to him, or if an execution is levied on the property on which the loan has been granted.[5]

1 Para. 16 of the Statutes of the National Economic Bank.
2 Para. 18 " "
3 Para. 29 " "
4 Para. 59 " "
5 Para. 44 " "

It was during 1927 that the National Economic Bank exercised for the first time the right to float loans in the form of bank debentures for the financing of industrial undertakings. The issues were made subject to the following regulations: the interest was fixed at 7½ %, the redemption period at 18½ years, and the minimum amount of a loan at 300,000 zl. and subsequently at 100,000 zl. These loans were primarily intended for assisting State enterprises or concerns in which the State was interested, but might also be granted to private industry. During the year six such loans were issued, totalling 12,692,000 zl.

Ever since the establishment of the Bank, it has displayed *considerable financial activity in relation to State enterprises: and in recent times has played an important part in the rationalisation of their production.* These enterprises may be defined to be those of which the State is the sole owner, or in which the State holds the major portion of the share capital, or which are of general importance to the State. One of the most important State enterprises to be financially assisted by the Bank was the Ursus Engineering Company, the first Polish firm to manufacture motor cars. In 1927 the Bank helped it to increase its capital to 15 million zl. and took up practically the whole of the new issue of 892,500 shares of 15 zl. each. It now came to own 89·61% of the issued capital of the Company.' In addition, the Bank promised at the end of 1927 to grant it a long-term loan of 4,130,000 zl. in the form of bank debentures. Besides the Ursus, the Bank participated during the same year in the share capital of the Propeller, Wood and Metal Works to the extent of 55·55% and made arrangements to grant the Starachowice Mining Company a long-term mortgage credit of 17 million zl. The chemical industry also received valuable financial assistance from the Bank. The Azot Company of Jaworzno not only received a debenture loan amounting to 2,565,000 zl. but the bulk of their new issue of shares was also taken over by the Bank, which now came to hold 66·81% of the entire issued

capital. Another concern, the Chemical Industry in Poland (the Prezemysl Chemiczny W. Polsce) was assisted to increase its share capital by 1,200,000 zl., the Bank promising to take up the greater portion of the new issue. The "Tesp" Potassium Salt Company, a concern engaged in the production of synthetic manures, also received considerable credits from the Bank for investment purposes.[1]

As regards long-term credits for private industrial undertakings, these were furnished in the form of cash loans and were chiefly intended for those concerns which had fallen into difficulties owing to the adverse economic position but had reasonable prospects of success. The following concerns were the principal recipients of such financial assistance from the Bank:—

(1) The Prezeworsk Company of Prezeworsk—5,500,000 zl. to meet its pressing engagements and also to start a sugar mill at Horodenca.

(2) The Grodek Pomeranian Electricity Supply Company at Torun—1,500,000 zl. for constructing a power line to Gdynia.

(3) The National Drainage Company—18,000 shares each worth 10 zl.

(4) The Polish Sea-Fishermen's Co-operative Union of Gydnia—200 shares valued at 10,000 zl.

(5) The Danziger Tabak Monopol A. G.—6·5% of its share capital.

Besides these companies, the Bank extended its assistance to the medium Polish Upper Silesian industries which were in great difficulties owing to foreign competition. The Katwoice branch of the Bank was authorised to grant to these undertakings an aggregate amount of 500,000 zl. to be secured by mortgages and repayable after two years.[2]

[1] Report of the Board of Directors for the financial year 1927 (Warsaw, 1928), pp. 29-30.

[2] Report of the Board of Directors, National Economic Bank, for the financial year 1927 (Warsaw, 1928), pp. 35-36.

The year 1928 witnessed a great development of the long-term sinking fund credits business. Of these again the granting of credits for industry and for building, rather than on mortgages of real estate, engaged the foremost attention of the Bank. During the year 17 industrial loans were accorded through the medium of bank debentures totalling 17,155,000 zl. Applications for such loans received by the end of the year amounted to a quarter of a milliard zl. But owing to the shortage of funds, the granting of such credits was restricted only to those undertakings which showed a promise of useful developments from the point of view of the interests of the State and of the economic life of Poland. Great care was devoted to the examination of the technical and financial standing of the concerns applying for aid; and applications amounting to 90 million zl. had to be rejected as these were not in a position to fulfil the conditions required by the Bank.

During the year the Bank participated to a considerable extent in the reconstruction of industrial enterprises and as a result its holdings in them increased substantially. The following figures indicate the remarkable growth of the Bank's holdings in industrial undertakings during 1925-1928 [1]:—

In Zlote (000 omitted)

1925	1926	1927	1928
1,097	5,734	20,113	46,285

As regards these holdings, they consisted generally of paid-up shares in artificial manure and chemical works, in the metallurgical industry and in the other enterprises in which the State had an interest for political or economic reasons.

[1] Report of the Board of Directors, National Economic Bank for the financial year 1928 (Warsaw, 1929), p. 38.

Among the industrial concerns in which the Bank was directly interested in 1928, the following may be mentioned :—

1. The Tesp Potassium Salt Company.
2. The Chemical Industry of Poland.
3. The Azote Company, Ltd.
4. The Grodzisk Chemical Works.
5. The Associatian of Polish Mechanics from America.
6. The Polish Accumulator Company.
7. The Pioneer Tool Works, Ltd.
8. The Starachowice Mining Company.
9. The National Amelioration Company.
10. The Ursus Engineering Company.
11. The Propeller, Wood and Metal Works (manufacturing wood and metal aeroplane propellers).
12. The Danzig Tobacco Monopoly.

State enterprises were furnished long-term cash credits to the extent of 9,939,000 zl., of which the greater portion went to the Tesp Potassium Salt Company, the Chemical Industry of Poland and the Starachowice Mining Company. As regards private industry, the Bank in accordance with its new programme of activity decided to withdraw gradually from industrial credits business. Hence during the year there was only a nominal increase in this class of credits. The principal recipients of long-term cash credits were the distilleries which were accorded 12,400,000 zl. The textile, paper and timber industries also received cash loans of 3,023,000 zl., 2,188,000 zl., and 2,560,000 zl. respectively.[1]

In 1929 the participations of the Bank in industrial concerns did not show any marked variations. The holdings of founders' shares in the different enterprises were only increased by the taking up of shares worth 1,000,000 zl. of the Jarot Timber Products Company.

Among the industrial interests of the Bank, the textile, chemical and metallurgical groups encountered great difficulties

[1] Report of the Board of Directors, National Economic Bank, for the financial year 1928 (Warsaw, 1929), p. 38

in effecting sales owing to the prevailing economic crisis and had to seek financial assistance from the Bank. The assistance was granted to an adequate extent in every case. The Bank also played a part in the reduction of their overhead charges and rationalisation of their processes of production.[1]

There was only one industrial loan against debentures amounting to 6,800,000 zl.[2] This particular type of loan could not be developed for various reasons. In the first place, the conditions prevailing in the money market were very unfavourable for the placing of debentures. Greater caution was also exercised in the granting of this kind of loan. The majority of undertakings which applied for this form of assistance were not in a position to fulfil the essential conditions imposed by the Bank. The financial position of a large number of them was so unsatisfactory that radical reorganisation was urgently called for. Hence the number of applications which had to be rejected after a preliminary examination was very great.

As regards long-term cash credits, State undertakings received 3,593,000 zl., while private industry was furnished 966,000 zl. only.[3]

During 1930 the National Economic Bank accorded three industrial loans totalling 1,820,000 zl. in bank debentures.

The Bank had decided in 1928 to withdraw from the field of industrial credits under its new programme of activity, leaving this aspect of the credit situation to the ever-widening field of the private banks ; and since 1929 the Bank has been following the policy of gradually reducing its commitments in associated industrial undertakings as well as of not increasing its interest in outside undertakings. An order of the President of the Republic, dated 3rd December, 1930, cancelled Art. 11 of its

1 Report of the Board of Directors, National Economic Bank, for the financial year 1929 (Warsaw, 1930), p. 32.

2 *Ibid.*, p. 30.

3 *Ibid.*, p. 40.

charter which gave it the right of industrial participation.[1] In the same year the entire holdings of the Bank in the Ursus Engineering Works were made over to the State Engineering Works. In addition to this, the book values of many shares and participations were written off and hence the balance-sheet item "shares and participations" dropped from 47,293,000 zl. on 31st December, 1929, to 33,753,263 zl. on 31st December, 1930, which were distributed as follows[2] :—

		Zl.
1.	Potassium Salt Exploitation Company ...	17,923,191·50
2.	British and Polish Trade Bank ...	7,157,950
3.	Danzig Tobacco Monopoly	2,142,035·78
4.	Bank of Poland	382,695
5.	Bank of Danzig	6,147,352·96
6.	Other Securities	88
		Zl. 33,753,263·24

In accordance with the new policy of the Bank long-term cash credits for associated undertakings and private industry were considerably reduced. The former received 2,000 zl. and the latter 879,000 zl. only as such loans. The State undertakings were granted long-term cash credits to the extent of 30,000,000 zl.[3]

In the course of 1931, three loans in 7½% bank debentures amounting to 1,620,000 zl., which had been authorised in the previous year, were paid out. But no fresh loans were authorised and no commitments were carried over for fulfilment in the next year. The greatest share of the industrial loans granted up to 31st December, 1931, fell to the mining, smelting and metallurgical industries (44·3% of the total) and the sugar

[1] Report of the Board of Directors, National Economic Bank, for the year 1928 (Warsaw, 1929), p. 48.

[2] *Ibid.*, for the year 1930 (Warsaw, 1931), p. 46.

[3] Balance-sheet of the National Economic Bank for the year 1930.

industry (20·5%). The textile, chemical, ceramic and mineral industries received smaller shares.[1]

Long-term cash credits furnished to associated undertakings and private industry were smaller as in the preceding year.[2] The former received 394,000 zl., and the latter only 563,000 zl. State undertakings received 31,040,000 zl.

The policy adopted in previous years, of reducing its interests in industrial undertakings, was continued by the Bank during 1931 and it sold its holdings in the Polish Accumulator Company and the Machine Tool Factory "Pioneer." Its participations and shares decreased by 2·4 million zl. to 31·3 million zl.[3]

During 1932 the long-term cash loans to State enterprises amounted to 30,365,000 zl. Enterprises associated with the Bank received no other credits except small short-term commercial credits. As in previous years, the Bank continued its policy of reducing its interests in industrial enterprises. The indebtedness of private industry in respect of long-term cash loans was only 586,000 zl.[4] The holdings of participations and shares, during 1932, comprised the following items[5] :—

		Zl.
1.	Potassium Salt Exploitation Coy. ...	18,229,106·66
2.	British and Polish Trade Bank ...	7,066,865
3.	Bank of Danzig	4,396,543·84
4.	Bank of Poland	1,698,938·80
5.	Danzig Tobacco Monopoly... ...	1,425,338·98
6.	Other Securities	79
		Zl. 32,816,872·28

[1] Report of the National Economic Bank, for the year 1931 (Warsaw, 1932), p. 35.

[2] The granting of credits to associated enterprises was restricted to exceptional cases, particularly those enterprises which were of importance to the State.

[3] Balance-sheet of the N. E. B. for the year 1931.

[4] Report of the Board of Directors, N. E. B. for the year 1932 (Warsaw, 1933), p. 42, p. 49 and p. 53.

[5] Balance-sheet of the N. E. B. on the 31st December, 1932.

The increase of 1·5 million zl. was entirely in Bank of Poland shares.

In determining the total indebtedness of industry to the National Economic Bank we have to take into account not simply the cash loans (long- and short-term) for private industry but also the loans in bank debentures, cash loans for State and associated enterprises, as well as a great portion of the loans in communal debentures granted to Local Government enterprises. Computed on these lines the total amount of industrial credits advanced by the Bank every year is found to be considerable, as is evident from the figures available for the years 1931 and 1932. In the former year the cash loans for private industry (including those from Treasury funds administered by the Bank) amounted to 148·9 million zl. To these should be added almost all the cash loans to State and associated enterprises amounting to 114·2 million zl., the loans in bank debentures amounting to 25·2 million zl. and a great portion of the 153·3 million zl. loans in communal debentures granted to various Local Government enterprises. The total amount of industrial credits thus amounted to 400 million zl. during the year.[1] Similarly in 1932 the cash loans to private industry amounted to 119·4 million zl. Besides, almost all the loans in bank debentures totalling 24·3 million zl., the majority of the loans in communal debentures amounting to 153·3 million zl. and 80 million zl. of the credits advanced to State and associated enterprises were for industrial purposes. As a result, the total share of industry in the credits granted by the National Economic Bank amounted, at the close of the year 1932, to 380 million zl.

The rôle of the National Economic Bank in relation to industry, though defined to be rather of a subsidiary nature,[2] is thus found to be not at all insignificant. It did not completely abandon its activities in the industrial sphere even after the

[1] Report of the Board of Directors, National Economic Bank, for the financial year 1931, p. 47.

[2] Exposé of Dr. Roman Gorecki at the Press Conference, *op. cit.*, p. 37.

Presidential order of 1930. Financial assistance rendered to industry by the Bank in the form of debenture loans and of short- and long-term credits continued to be quite considerable. In those cases specially where private banks were not able to meet adequately the requirements of industry and in the case of the heavy metallurgical and metal industry, the heavy chemical and other large industries, employing modern equipment, the Bank rendered in recent years useful assistance by providing long-term sinking fund credits in the form of bank debentures. As regards the long-term cash loans, those that were granted to industry during the economic crisis of 1924, 1925 and the beginning of 1926 were no doubt being gradually paid off, but owing to the general shortage of capital in the country, the Bank would probably continue to provide medium-term, if not very long-term credits, for some time to come. Besides, it played a very useful part in industrial rationalisation and concentration of production. The financial policy of the Bank in respect of industry was in recent years guided mainly by the principle of rationalisation and it always endeavoured to promote sound and far-sighted schemes of industrial reorganisation.

In concluding our review of the activities of the National Economic Bank it will be interesting to know how far the industrial loan policy of the institution was attended with success. In examining this question we should bear in mind the repurcussions of the world-wide economic crisis on every branch of Polish industry. Considering the acuteness of the economic depression, it is satisfactory to note that on the whole payments of instalments of industrial loans were not very unsatisfactory. In 1929 the payments of instalments were on the whole quite satisfactory and only one case was referred to Court. Owing to the further aggravation of the economic crisis, however, payments of instalments slowed down slightly in 1931 and 1932. Reference had to be made to Court and the properties of debtors had to be sold in a few cases. To safeguard its funds the Bank was also obliged to buy in some cases. But in all cases deserving consideration, the

Bank waived aside its right to foreclose in the event of arrears and generally prolonged the periods of repayments. On the basis of the Law of the 20th December, 1932, the Bank granted far-reaching facilities to its debtors. The interest charged on industrial loans was reduced to 5·5 % per annum, beginning from the second half-yearly instalments falling due in 1932, and the maximum period of redemption for industrial loans was fixed at 20 years.

CHAPTER XI[1]

FUTURE OF INDUSTRIAL FINANCE IN INDIA: AN INDUSTRIAL MORTGAGE BANK FOR INDIA

The analysis made in a previous chapter[2] clearly revealed that the defects and deficiencies of long-term industrial finance in India chiefly related to the lack of financial facilities during the development period and for extension, reorganisation and modernisation. The most serious gap existing in the financial machinery of the country was shown to consist in the entire absence of any suitable organisation for furnishing long-term loans to industries on the security of their fixed assets. The system of managing agency, which has played a very important part in the financing of industries in the country, has no doubt catered for these particular financial needs of Indian industries to some extent. But as already noted, the system has undergone considerable degeneration in recent years. The modern managing agents have not been able to keep up the traditions of the system and have seldom possessed the attributes which made the system so useful in the past. Besides, the managing agency system of financing is open to some grave defects.[3] Under the circumstances the future development of industrial finance in India does not lie there but should be sought in the establishment of a special machinery for providing the particular type of long-term finance, of which Indian industry stands in urgent need.

The question of establishing a special institution for solving the problem of industrial finance in India has been before the

[1] Published in the form of an article in the *Calcutta Review*, May and June, 1939.

[2] Chapter V, *supra* (pp. 122-26).

[3] See Chapter VI, *supra* (pp. 181-88).

country for a long time. The necessity of setting up such an institution was stressed by the Industrial Commission as well as the Central Banking Enquiry Committee. But no action except a half-hearted attempt in one or two provinces has yet been taken on their recommendations: their reports are resting in oblivion among the dust and cobwebs of the upper shelves of the Secretariat. In the recent times, as has been shown in the preceding chapter, the question of establishing suitable machineries for the long-term financing of industries has engaged considerable attention in several countries. Whenever it has been found that industries are unable to satisfy their long-term financial needs from the existing sources, the desirability of filling the gap in the financial machinery by establishing a special organisation has been strongly recognised. When attempts are being made elesewhere to set up machineries specially designed for providing long-term industrial finance, it is highly desirable that India should not lag behind. Her need for such an organisation is no less great than that of any other country.

Now the question is, what should be the model on which the future Indian institution will be framed? The task of choosing a model is not at all an easy matter and a great deal of the successful working of the organisation will depend upon the proper choice. In the last 15 or 16 years, during which Indian economists and publicists have been toying with the idea of specialist institutions for financing Indian industries, a variety of suggestions has naturally been made. But most of these suggestions have not been theoretically sound and have failed to appreciate correctly the functions and purposes of such a special type of institution, while others have had little practical value. The Indian Industrial Commission which favoured the establishment of an institution modelled on the lines of the Industrial Bank of Japan desired to confine the larger portion of its industrial business to the provision of working capital only. In this they failed to realise that the restriction of the business of such an organisation to the supply of only short-term working capital to

industry would defeat the very purpose for which it would be started. The problem of long-term industrial finance which is more complex and more acute would not be solved thereby. The attitude of the Industrial Commission entirely misconceives the nature and functions of specialist institutions designed for financing industry. Wherever such organisations have been set up, their object has primarily been the provision of long- and medium-term financial facilities for industry. The Indian Central Banking Enquiry Committee threw out a suggestion for the formation of Provincial Industrial Corporations but they did not develop the idea and details were not filled in.

The Industrial Bank of Japan has hitherto been the only model before India. Whenever a pattern has been sought for the future Indian institution, Commissions, Committees and economists have invariably turned to Japan. Even the "Foreign Banking Experts" who were invited to assist the deliberations of the Indian Central Banking Enquiry Committee believed that Japan was the only country where a specialist institution specifically designed for financing industries existed.[1]

A careful study of the structure and operations of the Japanese institution, however, has moved us to reject the Japanese model for India. The loans furnished by the Bank are not truly long-term and there is no statutory provision for amortisation, except for ship mortgage loans. An institution furnishing such type of industrial loans will not fulfil the real need in India for long-term industrial finance. Besides, it has combined issue business with industrial mortgage banking and has further added to it ordinary commercial banking. Such a mixture of various kinds of banking functions is not desirable.

The Japanese Bank, though a singular instance of a special institution for financing industry in the pre-war days, is not today the one and only institution engaged in long-term financing of industry. In seeking a model for India, therefore, we need

[1] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 638.

no longer turn to Japan alone. During the post-war years, in a number of European countries, it has been seen, a new machinery has been evolved for satisfying the long-term financial needs of industry. Industrial mortgage banking has been a very useful and interesting experiment in industrial financing attempted by these European countries. A considerable measure of success has already been achieved there and the same experiment may very profitably be made in India. An organisation closely modelled on the lines of these post-war industrial mortgage banks in Europe will be eminently suitable for the financing of industries in India. The main business of the Institution will be, as with its European confrères, the granting of long-term amortisation loans to industry against the mortgage of industrial real estate, land, factory buildings, machinery and plant, the necessary funds for its operation being obtained by issuing industrial mortgage bonds in addition to its own share capital.

All-India or Provincial Basis:

In recommending the establishment of a specialised mortgage bank for furnishing Indian industries with long-dated capital, the most important question that has to be decided is whether the proposed Institution should be founded on an All-India or Provincial basis. The majority of the Indian Central Banking Enquiry Committee decided in favour of the establishment of Provincial Institutions. Their decision, in this connection, appears to be reinforced by the recommendations of a number of Provincial Banking Enquiry Committees for setting up "industrial banks" on purely provincial lines. The most important single consideration that impressed them in favour of a Provincial Institution instead of an All-India one was the anxiety to safeguard provincial interests. A persistent fear seems to have haunted not only the Provincial Committees but also the Central Committee that in the event of a Central Institution being established, the particular interests of the provinces would be neglected. A national centralised Institute could

never be expected to possess the detailed knowledge of local conditions which the lending of mortgage loans requires. Independent provincial institutions, it was believed, would be much more useful in this direction than the Central Bank working through its branches and agencies. Only a Provincial Institution would be able to take proper care of provincial needs and aspirations. [1] We have, however, carefully considered all the arguments that have been adduced in favour of provincial institutions, and we are inclined to believe that the balance of advantage lies still in favour of the Central Institution.

The main function of the proposed Institute will be the issuing of industrial mortgage bonds. Now there are three essential elements in the mortgage bond: security, marketability and yield. A Central Bond Issuing Institute is calculated to promote the marketability and improve the security of the bonds decidedly in a greater degree than a Provincial Institute. As regards marketability, it is clear that, the bonds of the Central Institute, commanding an enormous amount of capital, having a well-known directorate and issuing a large number of these bonds, secured by a diversified parcel of properties all over the country, will provide a greater appeal to the investing public than the local small issue of a Provincial Institution. Such bonds will be sold both at home and abroad. Considering the extent of the capital market in India, it cannot be expected to respond quickly and easily to a number of separate bond-issuing institutions. [2] The home market is not sufficiently strong to provide all the enormous funds that may be required for financing the various industries of the country. The foreign capital market shall have to be tapped to obtain some of the necessary funds. The large national organisation will be better known and will command a much greater confidence than the smaller provincial institutions. The foreign investor is quite

1 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I.

2 *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 251.

likely to be interested in a national issue secured by widespread mortgages, although he may not be prepared at all to invest in locally secured bonds. As regards investors within the country itself, there are undoubtedly some who will prefer local securities partly for sentimental reasons and partly because they feel they can have a personal knowledge of the undertaking and of those who are in charge of it. Thus the Madras investor may be quite willing to put his money in a glass factory in Madras but will be reluctant to take an interest in a Punjab glass factory. But there is another aspect of the question. Bonds issued by the Assam Industrial Mortgage Bank may not be touched in Bombay, Madras or Bengal. But if it were a Central issue, the investor in every province will be interested. A large issue of bonds by a Provincial Bank may not find a ready market—may not find a market at all. Again, if the bonds are given any guarantee, that of the Central Government will undoubtedly inspire more confidence. The bonds issued by the Central Institute and guaranteed by the Central Government will enjoy a greater reputation both at home and abroad, and the requisite funds may be raised without much difficulty.

As regards the question of security, it has a twofold aspect. It has, in the first place, reference to the relations between the mortgage bank and the owner of industrial enterprises and in the second place to the relations between the bank and the bondholder. In the interests of the bank the loans granted will have to be safeguarded. It is also necessary that the would-be investors have to be induced to purchase the bonds by making them secure to the greatest possible extent. It is clear that the security of the bonds issued depends a great deal on the proper and scientific distribution of risks. With a central organisation, the opportunity for diversification of risks will certainly be greater than with a local institute. It is a root principle of investment banking to achieve the maximum diversification of risks. There are two principal bases on which risks can be diversified—geographical and generical. It is evident that

both these two forms of distribution can be obtained to the maximum extent in the case of an All-India Bank. So far as geographical distribution is concerned, the All-India Institute can reduce its risks to the minimum through careful selection of undertakings existing in different parts of the country. Different areas will be subject to different risks, because of different climatic, financial and industrial conditions. If there is a depression in the main industry of the province, say the cotton industry in Bombay, the jute industry in Bengal, the sugar industry in Bihar or U.P., the provincial institutions which may have advanced heavily to their respective industries will be reduced to a helpless position. The majority of their borrowers will default and a considerable portion of their assets will be frozen. The situation will not be so perilous if the institution were an All-India one. If there is a depression in one industry in one province, the Bank will on the whole maintain its position by the profits it may make with regard to the same industry in another province. Owing to purely local conditions, a depression may occur in the cotton mill industry in Bombay but not in Bengal. The All-India Bank will not be so vulnerable in the event of a provincial or local depression or in the event of a slump in a specific industry.

Risks can be distributed not only geographically but also generically by the All-India Bank much better than by the provincial institutions. The Central Institution can invest in many more different kinds of industry than a Provincial Bank. Except in the case of a world-wide depression, like the one recently witnessed, it is unlikely that all the different kinds of industry should be simultaneously caught in a slump. The depression in one or two industries can have little repurcussion on the general prosperity of the Bank. A substantial number of industries has to be affected and a substantial fall in the value of the mortgaged property has to occur before the Central Institute can be threatened with any disaster. Different influences will affect different types of industry and industrial property,

so that if one industry declines in value, the value of others may be well-maintained or may even rise. A Central Institute will be able to sustain itself better, because its investments will be very carefully distributed among various industries in various provinces and the chances of its being affected by an industrial depression will at the same time be comparatively smaller. If it is admitted that security both of the loan and of the bond-holder has to be ensured for the successful operation of the Mortgage Institute, the measures which will ensure maximum security must be adopted. The Central Banking Enquiry Committee failed to realise the gravity and importance of the question, when, carried away by an anxious desire to safeguard the narrow sectional interests of the provinces, they recommended the establishment of industrial corporations on provincial lines. Wherever industrial mortgage banks have been started, considerations of security and marketability have weighed so seriously with them that they have always attempted to diversify the risks of investment as much as possible by selecting different types and sizes of industry situated in widely different parts of the country. It may also be mentioned in this connection that a great deal of the successful working of the British Investment Trusts has depended on their policy of distributing the risks, geographically, industrially and denominationally.

A Central Bank will certainly be immune from the chief dangers which beset local banks, *viz.*, particular economic interests. It will be outside the pressure of local facts and the confusing influence of provincial patriotism. As Dr. Jeidels remarked, "If the organisation is too local, too provincial—local fight might arise about propositions submitted to the Corporation, everybody claiming that his proposition is the best The Corporation therefore ought, I think, to keep as much aloof from local influence as possible, particularly in the beginning."[1] Otherwise it "will run the danger of becoming a pandemonium of partisan struggle

[1] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 250.

and incompetence."[1] The encouragement of narrow sectional interests which is sought by the establishment of provincial institutions cannot be too strongly condemned. In economic matters, the promotion of separate provincial interests is highly injurious. So far as industrial development is concerned, it is never desirable as Mr. Manu Subedar rightly observes, to take a narrow view o provincial development in preference to an all-round nationa development.[2]

The preceding discussion has made it abundantly clear that the proper course would be to organise the future Industrial Mortgage Bank of our country on an All-India basis. But after careful consideration of the peculiar conditions of India—the vast area of the country, the existence of acute provincial jealousies—and of an anxiety to safeguard the interests of local and small industries we are inclined to restrict our proposed Central Institution to the business of issuing bonds only. We do not propose to entrus it with the responsibility of granting long-term loans direct to industrial concerns. The organisation that we are contemplating and that we believe would be the most suitable type for India is *an All-India Bond Issuing Institute and a number of Credit Granting Provincial Bodies affiliated to it but having no power of bond issues.* The two functions of granting loans and issuing bonds have been separated in our scheme and have been entrusted to two different bodies. The All-India Bank will have the absolute monopoly of bond issues, but, instead of lending direct to the industrialists themselves, will grant loans to the provincial or regional banks which will not be able to raise the necessary funds so easily in the capital markets of home and abroad. These provincial institutions will re-lend the proceeds of their loans from the Central Bank to the industrial concerns, handing over at the same time to the Central Institute the mortgages of their indus

[1] *Report of the Foreign Banking Experts*—Indian Central Banking Enquiry Committee Vol. I, Part I, p. 640.

[2] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part II (Minority Report), p. 341.

trial borrowers equal to the amount of the loan they receive. On the basis of the mortgaged properties, the Central Bank will issue a standardised bond of extraordinary strength and stability giving a definite specific yield. The Central Bank could lend with perfect safety upon the assignment of the large mass of mortgaged properties which the local institutes have taken from their clients as well as on the general security of the borrowing banks. The security consisting of mortgages in different parts of India in a number of provinces and relating to various industries and various kinds of industrial property would be extremely well diversified and almost unchallengeable. The Central Bank will make large issues of bonds and the funds that it will obtain will be re-lent to the provincial institutions. The price at which the capital will be raised will be charged to the latter with a small addition for administrative expenses and a reserve fund. The expenses of conducting the business will include the costs of the bond issues, the salaries of qualified officials, rent for bank premises, etc. The difference between the rates of interest received from the borrowing bank and the rates allowed to the purchasers of the mortgage bonds will constitute the main source of the income of the All-India Bank. The Bank need not and probably should not lend at the same uniform rate to all the provincial banks. Different rates may be charged to the borrowing banks according to their credit. Some restriction may also be imposed on the maximum amount that could be lent to a single Provincial Institute. The borrowers of the Provincial Institute will be charged a rate slightly higher than that at which the institutions themselves will receive their loans from the All-India Bank. The set-up that we are contemplating is also calculated to provide cheaper industrial finance than will ever be possible if independent provincial institutions were formed. The Central Institute will undoubtedly be able to place its issues at a rate of interest much less than that at which a number of smaller competing provincial banks making numerous issues will be able to do. If bonds can be sold at a cheaper rate, money can also be lent to the borrowing provincial

institutions at rates much lower than what they must pay when appealing directly and separately to the investing public. Cheap finance will filter down through the provincial banks to the owners of industrial enterprises and thus industry will enjoy exceptionally good financial facilities. It is significant that the French Credit Foncier and the Centralised Swedish Institute in the sphere of agricultural mortage credit, both of which possess absolute monopoly issues, have successfully placed their bonds at much cheaper rates than their smaller *confrères* in countries of similar conditions. The comparison is probably not conclusive as there are other elements to be considered, but there is ample ground to believe that this monopoly of borrowing power has had a great deal to do with this cheapening of interest rates.[1]

The division into a Central Bond Issuing Institute and a decentralised organisation of credit granting bodies will, we believe, be admirably fitted to the needs of the situation. The difficulties arising from the peculiar conditions of the home capital market will be solved, provincial jealousies will be satisfied, fears and suspicions will be allayed; and yet the set-up will be outside the pressure of local facts and the confusing influence of provincial patriotism. The three essential conditions in the mortgage bond—marketability, security and yield—will be satisfied as in no other scheme. Security and marketability will be maximised and a definite specific yield will be ensured.

In recommending this particular type of industrial mortgage bank for India, we have been greatly impressed by the Swedish models in the spheres of agricultural and urban credit. The Swedish General Mortgage Bank is the Central Bond Issuing Institute and lends the proceeds of its bond issues to district associations affiliated to it, upon the assignment of mortgages which they receive from their own borrowers.[2] In an analogous manner the Swedish Town Mortgage Institution centralises the

[1] J. L. Cohen, *The Mortgage Bank*, p. 128.
[2] Strickland, *Studies in European Co-operation*, Vol. II, p. 50.

bond issues for its affiliated urban credit associations and grants mortgage credits to them.

Our argument for a Central Bond Issuing Institute is further reinforced by recent developments in the history of mortgage banking. The advantages of a central national issue have become increasingly patent; and the post-war years have witnessed a remarkable development of the centralised mortgage bond. In every country there is noticeable an unmistakable tendency towards the creation of Central Bond Issuing agencies. The type based on Swedish experience is coming more and more into favour. An important instance is furnished by the Deutsche Kreditanstalt founded in 1925 on lines closely similar to those of the Swedish Mortgage Bank. It is a Central Agency for issuing bonds, the proceeds of the bond issues being lent to agricultural and co-operative associations.[1]

The growth of the concentration movement among mortgage banks illustrates the same tendency towards centralisation. The recent history of mortgage institutes in Germany, for instance, is dotted with fusions and amalgamations. The formation of Preussische Centralborden und Pfandbriefbank is a remarkable instance of this movement. Eight of the oldest mortgage banks in Germany also combined in the post-war years to form the Gemeinschaftsgruppe-Deutscher Hypotheken-banken to last at least 40 years.[2]

The advantages of a Central Institute in the sphere of agricultural credit have been considered to be so great and numerous that it has even been proposed to start an Imperial Mortgage Bank for the whole of the British Empire.[3] Such an institution with its headquarters in London might lend to the existing mortgage banks in the different parts of the British Empire which might be in difficulties to raise the

[1] J. L. Cohen, *The Mortgage Bank*, pp. 191-92.
[2] *Ibid.*, p. 119.
[3] *The Statist*, September 18, 1930, pp. 876-77.

necessary funds themselves. The Imperial Bank with much less effort and difficulty may obtain the requisite funds from the markets of the world by issuing bonds on the basis of the mortgaged properties in different countries of the Empire. The security and marketability of these bonds will be unquestioned. In the same way the question of setting up an International Mortgage Bank, standing in the same relation to the mortgage banks of the world as the Swedish Institution does to its affiliated associations, has been frequently canvassed in recent years. It has even engaged the attention of the League of Nations and has been actively studied, since January, 1931, by its Financial Committee and a special Delegation of this Committee. A concrete proposal for forming an International Agricultural Credit Company was drawn up by this body. It was considered in Geneva, in April and May, 1931, by a Sub-Committee of the Committe of Enquiry for European Union and was approved by the latter and also by the Council which appointed an Organisation Committee to take all necessary steps for its organisation.[1]

International Institutes for feeding the mortgage banks of several countries, though not of the whole world, have already been formed or are in the course of formation. The Institut Central pour Prets Hypothecaires was founded with a registered capital of 10 million florins in Amsterdam in 1930 by a body of leading bankers of different countries. Similarly the Internationale Bodenkreditbank was established at Basle with German, Swiss and Swedish capital, with an idea of issuing bonds to the public and purchasing with the proceeds the bonds of mortgage banks.[2]

The foregoing discussion has clearly revealed the recent tendency among mortgage institutes to establish Central Institutes and has amply demonstrated the advantages of the system of

[1] *Agricultural Crisis*, Vol. I, 1931 (League of Nations), p. 71.
[2] J. L. Cohen, *The Mortgage Bank*, p. 131.

having a Central Bond Issuing Institute in preference to decentralised provincial bodies. In the circumstances it is only logical that India should not take a retrograde step by establishing separate provincial institutions as the Central Banking Enquiry Committee recommended but should keep herself abreast of the times and, profiting by the experience of other countries, should form her future Industrial Mortgage Bank on lines parallel to recent world movements. The Government of the United Provinces have recently founded an "Industrial Credit Bank" for financing the industries of the provinces on the lines of the recommendations of the Industrial Finance Committee. An Industrial Credit Syndicate has also been established in Bengal under Government auspices for extending credit facilities to small industries. The organisations are conceived entirely on provincial lines and in the light of the preceding discussion can never be supported. In these days of planning, such piecemeal efforts on the part of Provincial Governments can hardly be approved. In order to reap the full benefits of a Specialist Institution and to ensure its successful working, it should be formed under the auspices of the Central Government, as we have suggested.

Amount and Mode of Subscription of Capital:

The question of the amount and mode of subscription of the capital of the proposed All-India Mortgage Bank should next engage our attention. As regards the amount, it must be emphasised that it should be such as would give the Bank a definite status both at home and abroad. As Mr. Manu Subedar has observed, the psychological factors of hopefulness and confidence among the public and business community, which are necessary for the proper functioning of such an Institution, must have to be created.[1] Wherever such Institutions have been formed, a fairly large initial share capital has been provided for,

[1] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part II (Minority Report), p. 844.

and there have generally been stipulations for a further increase of capital, if necessary. An adequate policy of distribution of risks is partly dependent on the size of the Institute. Agricultural Mortgage Institutes in Europe and America have, therefore, been, as a rule, more or less large-scale undertakings. In the sphere of industrial credit also, the Finnish, the Hungarian and the Saxon Mortgage Institutes have been started with a fairly large share capital. In the case of India the existing demand for long-term industrial finance is considerable. The industrial development of the country has also immense possibilities. Extension and reorganisation are urgently called for in most of her major industries. The potential needs of long-dated industrial capital must, therefore, be very great in the near future. All these factors have to be taken into careful consideration in determining the size of the Bank's capital. Various estimates of this size have been made. A well-known Indian banker estimated that the capital should be 50 lakhs to start with, and it may be gradually increased, if necessary. [1] A university professor's estimate was one crore, to be increased later on as the Institution should show signs of stability and success. [2] Mr. Manu Subedar in his Minority Report put it at 5 crores,[3] and a Chamber of Commerce proposed two to three crores.[4] The various Provincial Banking Committees which suggested the establishment of provincial industrial banks made different estimates of the initial share capital required by such institutes. The proposal of the Bombay Committee, for instance, was an authorised capital of 5 crores and a paid-up capital of 1 crore. [5]

But all this is mere guess work. It would be advisable to conduct a survey of the industrial conditions of the country before any decision is made as regards the size of the All-India Bank's

[1] Evidence (written) of Mr. (later Sir) S. N. Poochkhanawalla—Indian Central Banking Enquiry Committee, Vol. II, p. 42.

[2] Indian Central Banking Enquiry Committee, Vol. II.

[3] *Ibid.*, Vol. I, Part II, p. 344.

[4] *Ibid.*, Vol. II, p. 510.

[5] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 288.

capital. The survey should be made—as Mr. Nalini Ranjan Sarker, at present Minister of Finance, Bengal, suggested in a valuable note of dissent to the Central Banking Enquiry Committee's Report—by an expert body and should be sufficiently comprehensive so as to cover not only the immediate possibilities and scope of new industries which can be started but also the extent to which existing industries may profitably be expanded and reorganised, full account being taken of modernisation, extensions and replacements of plant and machinery.[1] It would be difficult to offer any estimate as to the size of the necessary share capital without this industrial survey. The nominal capital should be kept fairly high. The whole of the nominal capital need not be issued at once. A fairly good amount may be opened for subscription in the beginning and bonds may also be issued against industrial mortgages to the extent as recommended hereinafter. Further shares and bonds may be issued as and when required.

The capital of the All-India Bank should be contributed partly by the Central Government and partly by the various Provincial Institutions. The organisation scheme of the Provincial Banks will be as follows :—

The capital of a Provincial Institute will be divided into two classes—"A" and "B" stock. 75% of the shares will belong to Class "A" and 25% to Class "B." The former will be held partly by the Provincial Government, partly by the public and partly by the banks and other institutional investors. The "B" series of shares must be subscribed by the would-be borrowers of the Banks, industrial enterprises, whether private, jointstock or co-operative, to an amount equal to a fixed percentage, say 5%, of their borrowings. When the industrial borrower will have paid his loan and cease to be a borrower any longer, he will be at liberty to sell his share to a prospective

[1] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 334.

borrower or to transfer it to Series "A" shares which may, then, be sold to anybody. Series "B" shares should be made not transferable except to another industrial borrower or an individual eligible to become a borrower and then only with the approval of the directors of the Provincial Institution. But each holder of the Series "B" shares must, within two years after he has ceased to be a borrower, exchange his share at its fair book value, not exceeding par, as determined by the Institute, for a Series "A" share. By this provision, it will be possible to maintain permanent relations with the borrowers and to firmly establish the co-operative principle of joint liability. It is also to be expected that the Government Stock will be gradually retired as private investors subscribe for Series "A" shares, and Series "A" shares are substituted for Series "B" shares, when a borrower has paid his loan. The participation of borrowers in the share capital of the lending Institute has been an interesting feature of several organisations dealing in mortgage credit in recent years. The Industrial Mortgage Bank of Finland, Ltd., is an important case in point.[1] In the United States, in a different sphere of mortgage credit, the same provision requiring the borrower to subscribe to a certain fixed portion of the share capital of the credit granting body has recently been made. According to the American Agricultural Credit Legislation of 1933, *viz.*, the Emergency Farm Mortgage Credit of May 12, 1933, and the Farm Credit Act of June 16, 1933, borrowers of a Productive Credit Association must subscribe to its Class "B" stock, and the borrowing Associations must subscribe for stock in the Central or Regional Co-operative Banks, in amounts equal to 5 % of their total borrowings.[2]

[1] Report of the Industrial Mortgage Bank of Finland, Ltd., 1924. Also Letter to the writer from the Managing Director of the Bank.

[2] *Journal of Political Economy*, Vol. XLII, February, 1934, pp. 80-81.

Collective Liability :

The joint and several liability of the borrowers is a common feature of mortgage banks organised as mutual associations. In the case of agricultural credit co-operative associations, issuing mortgage bonds in their early stage, each member was held liable to the total value of its assets for the debts of the association. The debtor associations of the Swedish General Mortgage Bank are liable to an unlimited extent for the debts of the Central Bank in proportion to the amounts respectively borrowed by them. The borrowers of the associations themselves in turn are jointly and severally liable without limit for the obligations of their respective associations in proportion to the debts owed by them.[1]

At the present times, the liability of the borrower is limited as a rule to the amount of his own loan or to that part of it still outstanding or even to his share in the capital. As an instance of the case where the liability is related to the holdings in the share capital, mention may be made of the Belgian local banks which affiliate with Central Banks by subscribing one share at least, involving a liability limited to at least ten times the amount of the share.[2] In the Rentenbank Kreditanstalt of Germany, the agricultural debtor organizations are individually liable for the unamortised principal of the loan. The Municipal Mortgage Bank of Finland has laid down that the members will be jointly liable up to the amount of the difference of the loan outstanding and the value of the mortgaged property. In the Provincial Mortgage Bank of Saxony, which deals in industrial mortgage loans like the proposed Indian organization, the borrowers, it will be recalled, are jointly and severally liable up to 10 % of the loan granted.[3] A great deal of the security of the bonds issued by a mortgage institute which is a mutual association of borrowers depends on the collective liability, limited or

[1] Herrick and G. Ingalls, *Rural Credits*, p. 183, p. 218.

[2] *Ibid.*, p. 386.

[3] Statutes relating to the establishment of the Saxon Mortgage Bank, Sec. 9.

unlimited, of members. Combining Swedish with recent Saxon experience, we would suggest that the Provincial Institutes in India should be jointly and severally liable for all debts of the Central Banks up to 10 % of the loans granted. The borrowers of the Provincial Banks, the mortgagors themselves, should in their own turn be jointly and severally liable up to 10% of the loans granted by their Provincial Institutes. The bonds of the All-India Institute will virtually attain bed-rock security, as they will have not only the mortgages as cover but also the joint liability of the Provincial Banks and their industrial customers.

Proportion of Bonds to Share Capital:

As already stated, the Industrial Mortgage Bank of India will issue bonds against the securities of the mortgages handed over to it by the several Provincial Institutions. Besides the paid-up share capital, the main source of funds for its operation will come from the proceeds of its bond issues. An important question which must be settled at this stage is what proportion the bonds issued by the Bank will bear to its capital and reserves. The sums obtained by a mortgage bank by issuing its bonds are analogous to the deposits received by commercial banks. But while the funds of the commercial banks are essentially short-term, those of the mortgage banks are not so and may, therefore, be appropriately used for granting long-term loans, running for several years. Convention or law has laid down that commercial banks should maintain certain reserves to their liabilities. In the same way convention or law has stipulated that an equilibrium should be maintained between the bonds in circulation and the outstanding loans. Generally, the face value of the bonds in circulation should never exceed the total amount of the outstanding loans, and in addition to this the extreme limit of bond issues is fixed at a certain number of times the paid-up capital or the paid-up capital *plus* reserves, the total volume of bonds in circulation always bearing

a fixed proportion to the latter. In some cases, instead of stipulating for a fixed ratio between outstanding bonds and owned capital, the maximum bond issue is limited to a certain figure. The underlying idea in laying down such provisions is the prevention of excessive issue of bonds and the guarantee of the security of the bondholder. Mortgage banks whether agricultural, industrial, or urban, have almost invariably provided for some limitations to the issue of bonds. A study of a representative list of 22 agricultural mortgage banks in Germany shows that the bonds vary between 17 times the capital and reserves to 7·5 times, the average being 12 times.[1] The recently established Rentenbank Kreditanstalt, already referred to, has limited bond issues to six times the paid-up capital, which may be increased to eight times by special consent of the Reichsrat. In the case of agricultural mortgage banks generally the ratio has varied from eight to twenty-five times the paid-up capital.[2] In the field of urban and industrial credit, however, the limit is more conservative. The Industrial Mortgage Bank of Finland Ltd., has adopted the limit of ten times the capital and reserves.[3]

The Swedish Institute, recently devised to furnish middle- and long-term credits to industry, is to have the right of issuing bonds up to four times the capital guarantee and the reserve fund to be formed hereafter.[4] The Industrial Mortgage Bank of Saxony has limited its bond issues to 75 million RM.[5] and the Spanish Banco Credito Industrial to 150 million pesetas.[6] In the case of institutions issuing bonds or debentures, not necessarily mortgage banking institutions, the general rule is also to adopt some kind of limitations of bond issues. The British Investment Trusts have generally provisions putting some limit to

[1] J. L. Cohen, *The Mortgage Bank*, p. 144.

[2] M. T. Herrick, *Rural Credits*, p. 221.

[3] Letter to the writer from the Managing Director of the Bank, dated 6th November, 1934.

[4] *The Economist*, *Banking Supplement*, May 12, 1934, p. 14.

[5] Chapter X, *supra*.

[6] *The Banker*, June, 1933, p. 169.

their bond issues. The average of 50 of the leading British Trusts shows bonds to the extent of 39·26% of the total capitalisation or a ratio to total stocks outstanding of two to three. [1] The American Edge Law permits a company established under its provisions to issue debentures up to 10 times the aggregate capital and surplus of the issuing company. [2] There are, no doubt, some cases where the only limitations are those of the bond issues being equal to the mortgages granted. The National Hungarian Farmers Mortgage Institute operates under such a provision. But the additional rule fixing the extreme limit of bond issues is desirable to enhance the security of the bondholder. The recent trend is in favour of putting such a limit as may be observed from the case of the Finnish Industrial Mortgage Bank, which had originally provided that bond issues should be simply limited to mortgages granted. [3]

It is abundantly clear from the preceding discussion that some limitation should be placed on the amount of bond issues to be made by our proposed All-India Institute. The bonds should be made to bear some definite proportion to its share capital and reserve. It will tend to promote the security of the bonds and the confidence of the investors. It is surprising to find Mr. Manu Subedar advocating in his Minority Report that any hard and fast proportion of bonds to paid-up share capital need not and should not be laid down. [4] Another well-known Indian banker (Sir S. N. Pochkhanawalla) also made the point before the Central Banking Enquiry Committee that it was unnecessary to have any limitation on the debenture capital in relation to share capital. [5] All this is contrary to established theory and practice and cannot be accepted.

In suggesting the fixation of a ratio of bonds to share capital in the case of the Indian Institute, it should be remembered that

[1] Lawrence M. Speaker, *The Investment Trust*, p. 85.
[2] *Ibid.*, p. 79.
[3] Sec. 8, Articles of Association.
[4] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part II, p. 345.
[5] Indian Central Banking Enquiry Committee, Vol. II, p. 47.

the greater the proportion of bonds to capital and reserves, the smaller is the element of safety. Hence where the risk of investment is the greater, the relation of bonds issued to capital and reserves should be lower. Industrial Mortgage Banks cover their loans partly by mobile assets and hence must have the relation of bonds issued to capital lower than purely land mortgage banks which advance against real estate. But at the same time it would not be advisable to fix the ratio at too low a figure, not only because it is not necessary but also because it will hinder the proper functioning of the banks for lack of funds. The "Foreign Experts," who assisted the deliberations of the Indian Central Banking Enquiry Committee, recommended the ratio of 2 :1. Dr. Jeidels in the course of the discussions opined that it might just as well be 3 :1, if the capital were not less than one crore ; but the ratio under no circumstances should be higher. [1] The Central Banking Enquiry Committee was entirely guided by the opinions of Dr. Jeidels in the matter and recommended the adoption of the ratio of 2 :1. [2]

The restriction of bonds to share capital as recommended by the Experts and the Central Banking Enquiry Committee appears to us to be unnecessarily conservative and severe. We are inclined to think that a higher proportion would not only be sound and adequate but even necessary, so that it might not fall short of the reasonable requirements and might not injure the revenue earning position of the Bank by not providing the necessary turn over on which expenses could be spread out. In Mr. N. R. Sarker's note of dissent, already referred to, it has been suggested that the limit of 5 times the amount of the share capital may be adopted. This is a fair and reasonable limit and may be accepted. We would only recommend that the reserves should also be taken into account; that is, the bonds should be

[1] *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 238.

[2] Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I (Majority Report), p 302.

limited to 5 times the amount of share capital *plus* reserves. The ratio may be increased later on, if necessary, up to 10 times the amount of share capital and reserves but should not go beyond that.

State Participation of Share Capital and State Guarantee of Bonds:

We have proposed that State aid should be furnished to the Indian organisation in the shape of subscription to share capital. In the peculiar conditions of India we are inclined to believe that Government assistance, not only in the form of subscription to share capital but also in the form of a guarantee of the bonds of the Central Institute, will be necessary. The investing public here are proverbially shy and nervous. In order to make the bonds attractive to them and to draw out from them the required capital, it is essential that Government should not only hold some shares but should, at least in the beginning, guarantee the bonds. Even Dr. Jeidels admits that in the beginning the sale will be much easier with Government guarantee.[1] When his attention was sufficiently drawn to the peculiar circumstances in India, he did not strongly object to a temporary guarantee. The guarantee will be necessary to attract investors not only from within the country but also from without it. We have already stressed the necessity for tapping the foreign capital market and the guarantee is sure to inspire confidence in the foreign investors who may not otherwise come forward and open their purse-strings. It is satisfactory to note that the Central Banking Enquiry Committee recommended a guarantee of the interest on the bonds and further laid down that the guarantee should be limited to the first issue of bonds or to a certain period of currency of the bond issue.[2] It may,

1 *Discussions with Foreign Experts*—Indian Central Banking Enquiry Committee, Vol. IV, p. 247.

2 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 302.

however, be urged that such limited guarantee has some drawbacks, for the difficulty may arise that the public may be unwilling to take up subsequent issues when made without any guarantee at all. But it is expected that after a few years, when the public will correctly appreciate the nature of the organisation and be familiar with its working, the stimulus of a Government guarantee will not be required to induce them to invest. The same thing has happened in Japan and elsewhere.

In recommending this State participation of share capital and State guarantee of the bonds, we have been chiefly guided by the fact that State aid has been a predominant feature in almost all instances where Specialist Institutions have been started either for the financing of agriculture or of industry. There are numerous instances where the State has contributed wholly or partly the capital of agricultural mortgage banks or guaranteed their bonds. Even in England the Agricultural Mortgage Corporation received a Government subsidy and its debentures were guaranteed by the British Government. It is the same story with the recently started Industrial Mortgage Banks in Europe. The entire capital of the Saxon and 80% of the capital of the Hungarian Institution have been contributed by the respective Governments, while the bonds of the Finnish and the Saxon Banks and the "bank debentures" of the Polish National Economic Bank placed on foreign markets enjoy a Government guarantee.[1] The debentures of the Japanese Industrial Bank issued abroad were also guaranteed by the Government in several instances. In the case of the Industrial Credit Company of Ireland established under the provisions of the Industrial Credit Act of 1933, the Irish Government have taken up all shares left unsubscribed by the public as contemplated by the Act. Of the first issue of £500,000 offered for public subscription in November, 1933, £492,064 had to be taken up by the Minister of Finance, the public having sub-

[1] See Ch. X, *supra.*

cribed only £7,936. Of the second issue of £500,000 in July, 1936, the public took up only £175, the balance of £499,825 being subscribed by the Government.[1]

It may be mentioned, in this connection, that State-aid has been furnished to the recently started "Industrial Credit Syndicate" of Bengal in the form of a contribution to its administrative expenses and of a partial guarantee of losses of capital that may be incurred by it. Under the terms of an agreement with the Provincial Government, the latter have undertaken to pay to the Company (a) one-half of any losses of capital attributable to the first ten lakhs of rupees lent by it, (b) one-half of any losses of capital attributable to any amount lent by it after and in addition to its first loans and (c) in respect of each of the first five financial years the amount properly expended by it in administrative expenses in each of the said years or Rs. 20,000 whichever be the less.[2] The extension of State-aid in these forms is not calculated to ensure a sound and satisfactory working of the company ; for all incentive to good management will disappear under such conditions.

Business of the Industrial Mortgage Bank of India :

As we have already suggested, the All-India Institute will confine itself to the issuance of mortgage bonds and will not furnish loans direct to the industrial concerns. The main business of the provincial institutes will be the provision of long-term amortisation loans to industries, jointstock, co-operative and in some instances even private. The loans, as is usual with the post-war industrial mortgage banks in Europe, are to be furnished on first mortgages of industrial real estate, land, factory buildings, hydro-electric installations, machinery, plant, etc. Certain types of property have been regarded as undesirable security for mortgage loans, and mortgage banks, in many

1 Report of the Commission of Enquiry into Currency, Banking and Credit, Ireland, 1938, p. 269.

2 Prospectus of *The Industrial Credit Syndicate, Ltd.*, March, 1937.

cases, have been specifically prohibited from lending against such security. Theatres, mines and quarries belong to this category and have been excluded from the business of several mortgage banks, such as the French Credit Foncier, the Polish National Economic Bank and the National Mortgage Bank of the Argentine. Such properties are incapable of returning money in a regular manner and do not constitute proper bases for the issue of bonds. It will be unsound for an institution of the type we are contemplating to grant loans against such security. Mortgages of ships as basis for the issue of bonds will also be extremely insecure owing to changes and rapid decrease in value and the material difficulty in enforcing claims.[1] Although ship mortgage business was a favourite line with the Industrial Bank of Japan and although ship mortage banks have recently been established in several European countries, we would like to debar our Indian Mortgage Bank from engaging in such business.

The proportion which the amount of the loan will bear to the approved value of the industrial property offered for mortgage will have to be carefully determined. The law relating to mortgage banks in every country has, generally speaking, laid down that the amount of the loan to be granted should never exceed a certain fixed percentage of the estimated value of mortgaged properties. In the case of agricultural mortgage banks the percentage is very liberal and has varied from 40 to even 75%.[2] In the case of the European industrial mortgage banks, the percentage is distinctly lower and more conservative, and has not exceeded 50% and in some cases is even 30%. In fixing the percentage in the case of the Indian Bank, the practice prevalent in other countries should serve as the guiding star. It should be stressed that the agricultural mortgage

[1] J. L. Cohen, *The Mortgage Bank*, p. 196.

[2] The National Mortgage Bank of Greece, the Royal Swedish Mortgage Bank, the Land Mortgage Bank of Warsaw, the Hungarian Land Mortgage Bank and the Agricultural Mortgage Bank of Columbia have the limit fixed at 50%. In Italy and Belgium the limit is 66 2/3 % and in the Netherland Institutions it is 75%.

banks make their loans entirely on real estate, while industrial mortgage banks partly on mobile assets, at least on assets not so immobile as in the other case. The question of the relative security or insecurity of industrial morgage banks will engage our attention later on. But at the present moment their assets being more mobile, these may be considered to be subject to relatively more rapid depreciation, and hence there should be a higher margin of safety here than in the case of agricultural mortgage institutes. The latter may with comparative safety lend up to 60% or even 75% of the estimated value of the mortgaged land, but such a policy will not probably be wise for the industrial mortgage banks.

The amount of the loan should be restricted to a more conservative proportion of the appraised value of the industrial property offered as security. But at the same time it must be considered that if the percentage fixed is too low, it will spell great inconvenience to the borrower who will find it difficult to satisfy his requirements, and it will thus defeat the very purpose for which the Bank has been started. We are inclined to believe that consistent with safety to itself and convenience to the borrower, the amount of the loan made by the Indian Institute should not exceed 50% of the value of the land, 40% of the buildings, and 30% of the plant and machinery. If water power forms a portion of industrial property, loans may be made up to 30% of its estimated value as in the case of the National Economic Bank of Poland. To increase the security, the mortgage of additional properties may be demanded in any case. Such practice is not unknown with the industrial mortgage banks of Europe.

Purpose of the Mortgage Loans:

The loans granted by the Provincial Mortgage Institutes should be for extension, modernisation and replacements of plant and machinery. They should play an important part in the rationalisation of industry. Re-organisation is urgently called

for in a large number of Indian industries and our Bank should earnestly devote itself to the financing of the re-organisation schemes. The Japanese Industrial Bank has filled an important rôle in the rationalisation of Japanese industries in recent years. Although the Indian Central Institute will not lend direct to the industrial concerns, it will exercise a general supervision over the loan operations of the provincial institutes and whenever rationalisation is called for, it would see that primary attention is given to the financing of schemes of rationalisation.

As regards the provision of initial finance to industry, in all discussions relating to the establishment of a specialist institution for financing industries in India, it has been urged that the institution should have statutory power not only to furnish long-term loans but also to take up and underwrite industrial shares and debentures. The majority of the witnesses who appeared before the Central Banking Enquiry Committee suggested that the future Industrial Bank of India should provide a part at least of the initial block capital of industries. The Majority Report preferred not to discuss in detail the specific business to be undertaken by the Industrial Corporations recommended therein. Mr. Manu Subedar in his Minority Report advocated that the All-India Bank should take up preferential capital of new concerns up to one-third of the amount subscribed by the public as well as debentures.[1] Mr. N. R. Sirkar in his minute of dissent also laid down that one of the most important functions of the Indian Institute should consist in underwriting and subscribing shares of industrial companies.[2]

In all these schemes the issue and underwriting business has been combined with that of making long-term loans. The example of the Japanese Industrial Bank and its forerunner the French Credit Mobilier must have exercised a great deal of

[1] Indian Central Banking Enquiry Committee, Vol. I, Part II (Minority Report), p. 347.

[2] *Ibid.*, Vol. I, Part I, p. 544.

influence. But if the Institute, as we have contemplated it, is to furnish long-term mortgage loans, it will not be desirable to mix it up with issue or underwriting business. Nowhere, to our knowledge, has a mortgage bank done so. We have made a careful enquiry into the working of the recently established Industrial Mortgage Banks of Europe and we have been informed by their authorities that they do not make it their business to provide initial capital to industrial concerns by subscribing to their shares The National Economic Bank of Poland, which is, however, an omnibus institution dealing in all kinds of mortgage and other credits, used to provide initial block capital to joint-stock companies in this manner ; but by an order of the President of the Republic, dated the 3rd December, 1930, Art. 11, of its Charter which gave it the right of industrial participation was cancelled.[1] The Industrial Bank of Japan does indeed combine investment trust business with that of industrial mortgage but we have already stressed the undesirability of such practice and have indicated it as one of the main reasons for rejecting the Japanese model for India.

If the proposed Indian Institution were to engage in underwriting and holding business, it would be involved in serious risks and heavy responsibilities. The question assumes a particular importance as the State participates in the share capital of the Company; for the State in turn will be involved in the same risks and responsibilities. This constitutes a sufficient ground for questioning the propriety of such an Institution taking up underwriting and investment trust business. As the recent Irish Banking Commission have observed, " If it were desired that the State should participate in any large degree in individual enterprises, it would clearly be preferable that the enterprises should be openly and definitely chosen for this purpose under suitable statutory powers and safeguards rather than they should be

1 Report of the Board of Directors, National Economic Bank for the year 1930 (Warsaw), p. 46.

determined in a disguised and accidental fashion through the medium of such a Company."[1] Besides entailing direct acceptance by the State of speculative interests in industry, the holding business would tend to create a position of difficulty with respect to the Stock Exchange. As one of the largest shareholders in many cases, the Institute would attain a position of undesirable predominance in regard to the market in shares. The immobilisation by the Institute of a substantial block may even conflict with the interests of the industrial concern.

It is interesting to note that the above considerations weighed so strongly with the Irish Banking Commission (1938) that they recommended in the case of the Industrial Credit Company of Ireland, which combines issue and underwriting business with that of long-term loans, the restriction of the former type of business and the development of the latter.[2]

It may, however, be argued that if the proposed Indian organisation does not furnish initial block capital, it will but touch only a fringe of the problem. But it may be suggested that when the industrial company has raised a certain portion, say 50%, of its share capital, it may invest it in land, buildings or machinery which in turn may be offered as the basis of a loan from the industrial mortgage bank. The subscription or underwriting of industrial shares should never be the business of a mortgage bank.

Duration of Industrial Mortgage Loans :

The loans granted by the Provincial Institutes should be long and medium term. In the case of agricultural mortgage banks, a real estate loan runs from 10 to even 75 years. Evidently industrial mortgage loans cannot run for 50 or 60 years.

[1] Report of the Commission of Enquiry into Currency, Banking and Credit, Ireland 1938, p. 274.

[2] *Ibid.*, p. 276.

Industrial property, as already pointed out, is subject to more rapid changes in value, and plant and machinery depreciate quickly. Under the circumstances, the industrial mortgage banks have nowhere adopted the practice of their *confrères*, the agricultural institutes. The Banco Credito Industrial of Spain appears to be the only institution dealing in long-term loans to industry which was authorised to advance for 50 years.[1] But this is not at all a sound practice for an institution of such a type. While on the one hand the period for which the loans will be granted should not be fixed so long, on the other hand, it should not also be too short to be termed reasonably long-term. The mortgage loans of the Japanese Industrial Bank to industry in general do not run for periods of more than five years. Dr. J. C. Sinha, following the Japanese Bank, suggested in an article in the *Modern Review* that the long-term loans of the future Indian Institution should not be for a longer period than five years.[2] But five-year loans can never be considered to be reasonably long-term and if the proposed Indian Institution were confined to the granting of such loans, the problem of long-term industrial finance will never be solved in India and the whole set-up will be of little practical value. Mr. Manu Subedar suggested a period of 10 years but even this is not long enough. The practice with all specialist institutions, designed in recent years for long-term financing of industry, has invariably been to grant loans for periods much longer than five or even ten years. Twenty or twenty-five years have been the usual period for long-term mortgage loans to industry, as may be observed from the instances of the Finnish and the Hungarian Industrial Mortgage Institutes. In the case of the National Economic Bank of Poland, the maximum period of redemption of industrial loans was originally fixed at 18½ years but it was extended to 20 years by a law of 20th

1 *The Banker*, June, 1933, p. 169.

2 *The Modern Review*, January, 1932, p. 66.

December, 1932.[1] The "Credit for Industry Ltd.," which has recently been established in England for financing small and medium sized industries, is granting loans for periods ranging from two to twenty years.[2] The recent Report of the Irish Commission of Enquiry into Banking, Currency and Credit recommends twenty years as the maximum period for which loans may be sanctioned by the Industrial Credit Company.[3] The long-term industrial loans of the proposed Swedish Institute will be over 10 years and the medium term ones will run from 1 to 10 years.[4] Our Provincial Institutions, under the circumstances, may very well advance for periods of at least 15 years and even 20 years. The 20-year period should not be exceeded. Industrial property, plant and machinery depreciate pretty rapidly and a longer period may wipe away a considerable portion of the value of the security offered. The middle-term credit may run from two to ten years.

The long-term advances of the Institutes should have provision for amortisation. Of the schemes that have hitherto been formulated for an Indian Industrial Bank, there does not appear to be one which provides for amortisation. The system of amortisation is extremely needful and beneficial to all borrowers of long periods. It eases their burden and enables them to pay off the loan gradually by the slow returns of business. It has been aptly observed, "Without it every real estate credit system is an incomplete and fragile scaffold, deceiving the public and endangering the welfare of any nation."[5] There are two principal methods by which an amortisation loan may be extinguished, those of the German Landschafts and the French Credit Foncier. Under the latter system, the annuity, deter-

[1] See Chapter X, *supra*.

[2] *The Times, Trade and Engineering Supplement, Banking Section*, June 30, 1934, p. 8.

[3] Report of the Commission of Enquiry into Banking, Currency and Credit, Ireland, 1938, p. 276.

[4] *The Economist Banking Supplement* May 12, 1931, p. 24.

[5] Royer, Quoted by Herrick, *Rural Credits*, p. 22.

mined by the length of credit and the agreed rate of interest, remains the same during the entire period of the loan and is usually paid in semi-annual instalments. This is the system that has generally been adopted by the industrial mortgage banks and in the case of India, the loans granted by the Provincial Institutes may also be made repayable in annuities in semi-annual instalments. These annuities will be made up of interest, amortisation and cost of administration. An additional payment may also be demanded in the form of risk amounting to, say $\frac{1}{4}$%, as in the case of the Provincial Mortgage Bank of Saxony.[1]

Deposits and Short-Term Loans :

Mortgage banks, as a rule, are prohibited from encroaching on the territory of commercial banks. On the one hand, they cannot receive deposits and on the other, they must not grant credits except on mortgage. The question of receiving deposits and of the provision of short-term funds for industry has been frequently raised in connection with the function of the proposed Indian Institute and it also came up before the Central Banking Enquiry Committee. A prominent Indian banker told the Central Banking Enquiry Committee that the Industrial Corporation might receive deposits for periods of not less than three years.[2] The Committee itself also favoured the idea of taking long-term deposits by the Provincial Industrial Corporations proposed by them.[3] But we are inclined to believe that it will not be a legitimate function of industrial mortgage banks to invite and accept deposits whether long- or short-term. It would not only be a competition with existing joint-stock banks but it would also be outside its proper sphere. The cases where mortgage institutes

1 See Chapter X, *supra*.
2 Indian Central Banking Enquiry Committee, Vol. II, p. 42.
3 *Ibid.*, Vol. I, Part I (Majority Report), p. 302.

have been permitted to receive deposits are very few and even there the amount has been limited. The Industrial Mortgage Bank of Finland, so we have been informed by its authorities, does not receive any deposits at all.[1]

As regards the question of granting short-term loans, there are two aspects from which it may be viewed. First, mortgage institutes have frequently funds not required for immediate investment. These funds, it is suggested, may be permitted to be utilized for short-term loans. And secondly, industrial enterprises which have mortgaged their real estate to them are likely to find it difficult to raise their working capital from the ordinary channels. Under the circumstances, it may, perhaps, be necessary for the Industrial Mortgage Bank to furnish working capital to industry.

It is undoubtedly desirable that the two functions of making long- and short-term loans should be segregated and vested in entirely different institutions. In a few cases mortgage banks have, no doubt, been known to cultivate the business of short-term loans with some restrictions. The two striking examples in this respect are the Municipal Mortgage Bank of Finland and the Credit Foncier of France. But generally speaking, neither the agricultural mortgage institutes nor the recently established industrial mortgage banks in Europe make it their business to advance short-term funds or working capital. The Managing Director of the Industrial Mortgage Bank of Finland informs us that the Institute does not engage in ordinary banking business nor does it furnish working capital to industry.

The free funds of the mortgage institute are sometimes permitted to be invested temporarily in certain listed bills and securities or utilized in purchasing their own bonds and even making loans on certain specified securities. The Industrial

[1] Letter to the writer from the Managing Director, The Industrial Mortgage Bank of Finland, dated 6th November, 1934.

Mortgage Institute of Hungary is a case in point.[1] While we cannot advocate with Mr. Manu Subedar that the Industrial Bank of India will advance short-term loans to industry, we would suggest that the free funds of the Institute may be invested temporarily in the same way as those of the Hungarian Bank. The working capital of industry should be obtained partly from paid-up share capital and partly from the commercial banks. As regards the question that industrial concerns which have mortgaged their real assets to the mortgage institute may find it difficult to raise their working capital from the ordinary banks, it may be interesting to point out that no such difficulty has been experienced by the Finnish industries which have offered their fixed assets as security to the Finnish Mortgage Bank.[2]

Restrictions on the business of the Mortgage Institute:

What would be the field of operation of the proposed Indian Institute? Will its sphere be limited to non-competitive lines of industry? Will it avoid small industries? These are questions which should now engage our attention.

Dr. Jeidels and the other "Foreign experts" following him were definitely of the opinion that the business of the Indian Industrial Corporation should be restricted to non-competitive lines of industry. An Industrial Corporation, financially assisted by Government, writes Dr. Jeidels in his memorandum, must not enter competitive fields of industry but should be restricted to "the field of pioneer enterprise of non-competitive character, the opening up of mineral resources and large public utilities, principally electrical power schemes."[3] It would be restricted to such fields not only because they are non-competitive or almost so but also because "in order to establish the reputation of such

1 Articles of Association, para. 51. The National Hungarian Industrial Mortgage Institute, Ltd., 1929.

2 Letter to the writer from the Managing Director, *op. cit.*

3 Report of the Indian Central Banking Enquiry Committee, Vol. I, Part I, p. 689.

Industrial Corporation, one ought to start with something assured of success, avoiding the risk which naturally lies in such ventures as glass, pottery, electric goods and chemicals, etc."[1] In discussing Mr. N. R. Sarker's note, Dr. Jeidels and the other experts made it quite plain that they viewed with alarm any suggestion that the industrial bank should extend its operations to a large variety of industries.[2]

The position taken by the foreign experts is quite untenable. It was also rejected by the Central Banking Enquiry Committee. The Industrial Mortgage Banks after the pattern of which we have suggested the formation of the Indian Bank have in every case been endowed with some form of State-aid, including State participation of share capital. But nowhere has any attempt been made to restrict by Statute the operation of such banks to the class of business recommended by the "Experts." A perusal of their annual reports makes it abundantly clear that they finance every kind and every branch of industry. Iron and metal, chemical, woolen, cotton, silk, printing and publishing, paper, food stuff, china, toy and brick industries are some of the most important assisted by the Hungarian Institute.[3]

The Saxon, the Finnish and even the Polish institutions have similarly financed a wide variety of industries.[4] No limit has also been imposed on the character of the business to be engaged in by the more recent specialist institutions which have been or will soon be established under the auspices of the State. In Italy, although State-aided institutions have been started for granting long- and middle-term credits to public works and public utility undertakings, the Istituto Mobiliare Italiano was also created in 1931 to be entrusted with the financing of industrial concerns generally.[5]

[1] *Discussions with Foreign Experts,* Indian Central Banking Enquiry Committee, Vol. IV, p. 231 and p. 237.

[2] *Ibid.*, Vol. IV, pp. 611-42.

[3] Report of the National Hungarian Industrial Mortgage Institute, Ltd., 1931.

[4] See Chapter X, *supra.*

[5] *The Statist,* July 15 and October 21, 1933, pp. 91 and 548.

Any attempt to restrict the programme of the future Industrial Mortgage Bank of India to public utility companies and non-competitive lines of industry will not only defeat the very purpose for which it has been created but will also be fraught with disastrous consequences in that proper diversification of risks will not be achieved. . . . .

As regards the question of assistance to small industries the opinion of the "Foreign experts" was definitely against it. But we are inclind to think that our mortgage institute should cater for the long-term needs of all kinds of organised industries, large, medium and small. Such a policy will undoubtedly secure diversification not only according to nature of industry but also according to size. The practice of the Saxon and Hungarian Institutes tends to support our views in this respect. The Industrial Bank of Japan has not also confined its assistance to large industries, as the "foreign experts" believed, but has liberally assisted small and medium-sized industries as well in post-war years. There will be many practical difficulties in working a separate institution in India for financing small enterprises in addition to the set-up contemplated by us. The contention that the interests of the smaller enterprises will be neglected by an Institution of the type recommended may be disposed of by suggesting that the directors of the provincial institutes should include representatives of smaller industries who will look to their particular interests. The directors might be of two types, Class A and Class B, the latter to include the representatives of the smaller industries.

Appraisal :

Accurate appraisal is a very important problem with mortgage banks. Everything depends on the proper valuation of the property offered for mortgage and the margin of safety allowed; since this constitutes the security not only of the bondholder but also of the Bank itself. The Bank must be very strict in the

examination of the industrial property to be mortgaged. Different kinds of industrial property have to be valued in different ways; and separate appraisers may have to be employed for that purpose. Thus the Finnish Institution has employed different "assessors" for valuing buildings and machinery, for landed and forest property and for water-power. The appraisers should not only concentrate their attention on present market values but should also take a broad view of the general prospects of the industry in future.

The All-India Bank would require some machinery for examining the mortgages offered but this need not be elaborate. It will rely to a great extent upon the judgment of the borrowing banks which give their additional pledge. It is the Provincial Institutes which have to employ a well-equipped staff of experts, statisticians, businessmen, lawyers, engineers, accountants and economists. The Directorate may be so selected as to include some experts. The staff of experts will sift out the desirable proposals from among the many applications for loans, will assess properly the various forms of industrial property offered as mortgage and will also make full enquiries concerning "finance, production, sales and market capacity and personnel" of the businesses applying for loans. Industrial concerns having a fairly satisfactory trading record over a period of years, in a sound financial position and well managed at the time of application, should be primarily assisted. Every facility should be given to those who have already succeeded in building up business to a certain point so that further progress may be made possible. The financing of newly established concerns should not be too strictly prohibited. A new industry should not be viewed with instinctive suspicion and turned down at once. Every proposition should be judged on its own merits.

Special Privileges and Safeguards :

The Bank is to be surrounded with special privileges and safeguards as is usual with mortgage institutes, whether agricul-

tural or industrial. The rights of such institutes have to be very carefully protected in the interests of the bondholders. The bonds which are the main source out of which they derive their necessary funds have to be popularised among the investing public and extraordinary facilities have therefore to be accorded to the banks to collect their dues. The process allowed for realising arrears of interest and annuity has to be particularly quick and effective. In all cases they have been endowed with the right to take drastic proceedings against a delinquent borrower. On appeal the Courts must also give their decision swiftly and summarily, the records of the mortgage bank constituting indisputable evidence. The bank has frequently the right to be appointed "sequestri curator" of the mortgaged properties. The claims of the bank take precedence over all other claims. No third party can acquire any claim over the properties and assets mortgaged by the borrowing concern. The Indian Institute must have to be endowed with similar rights and safeguards so that it may function well. In every case the buildings, machines, tools, implements, etc., which have been offered for mortgage must be insured against damage by fire, earthquake or any other casualty with an insurance company approved of by the lending provincial bank. Audit and revaluation of assets must be permitted at any time. As regards the right of the borrower to repay his loan before the appointed time, he may be permitted to do it but a stipulation should be made that a notice of repayment should be given and a redemption fee should be paid as is demanded by the English Agricultural Mortgage Corporation. It must be remembered that the Bank will have its own liability for its bond issues and having regard to that it should not allow non-contractual payments to be readily made but it should fix a redemption fee sufficient to be commensurate with the cost of the funds it employs.

Central Register of Industrial Mortgages :

The framing of a Central Register of Industrial Mortgages

as is to be found in Hungary is a condition precedent to the establishment of an Industrial Mortgage Bank for India. Without such a register, it will not be possible for the Bank to know immediately whether it is advancing actually against a first mortgage. The existence of prior mortgages, if not known, will detract from the value of the property and thus injure the interests of the Bank. It is essential for the development of a proper system of mortgage credit that safeguards should be introduced against the mortgaging of the same piece of property several times without disclosing the fact of prior mortgage to the later lenders. A great check to such abuses in the sphere of agricultural mortgage credit is furnished by the "grundbuch" of Germany. It is a real estate register, registering the property, relationship and the debt burden of every piece of land. It is open for inspection to all interested parties and embodies the principle of priority over all other rights entered subsequently. Following Germany, most Central European countries have developed a complete machinery for registering mortgages in a "grundbuch." A Central Register of Industrial Mortgages, embodying all the details of ownership, rights of third parties, etc., is likely to be much more advantageous than the "purge" method of the "Credit Foncier" of France. According to this method, advertisements are made in papers inviting objections from possible creditors to a proposed loan on the mortgage of real estate. It is no doubt speedy and safe and at the same time dispenses with the necessity of fresh legislation. But it exposes intending borrowers to a blaze of unwelcome publicity and is not therefore likely to be relished by them. The experience in India under the State-Aid to Industries Acts when objections to applications of loans have similarly been invited by advertisement in newspapers and Government Gazettes has not at all been happy and does not warrant a repetition of the same system in the Mortgage Bank. All these considerations have impressed us in favour of instituting a Central Register in every province.

Relative Insecurity of Industrial Mortgage Banks:

The extension of the principles of mortgage banking to the field of industrial credit has not been favourably received in some quarters ; and the establishment of industrial mortgage banks which will grant long-term loans on mortgage of industrial real property, machinery, plant, factory, buildings, etc.: has been viewed with considerable misgivings. Agricultural land is as good as permanent and seldom undergoes depreciation so quickly and so considerably as to wipe out the security. Industrial property however, is, subject to more rapid depreciation than agricultural real estate. Owing to changes in value and rapid depreciation, industrial plant and machinery which are used as bases for the issue of industrial mortgage banks have been considered to be very insecure. But it must be pointed out that agricultural property is subject to fluctuations and trade-cycles and depressions even much more than industrial property. In recent years the magnitude of fluctuations in agricultural rent and prices has been indeed enormous. The phenomenal rise during the Great War was quickly followed after 1920 by a catastrophic fall in the whole world of agriculture. An interesting feature of the recent world-wide economic crisis was that the fall of agricultural prices was relatively greater than that of manufactured goods. Agricultural property in the recent depression has undergone a depreciation of value much more serious than industrial. The collapse of agricultural prices has been so severe that there is a striking tendency among several banks primarily designed for furnishing agricultural mortgage credit to invest increasingly in urban real estate. An outstanding example is that of the French " Credit Foncier."

An industrial mortgage bank has one single advantage of considerable importance over agricultural and other mortgage banks in that it can distribute its risks of investment much better amongst widely different types of undertakings. Every kind and every size of industrial enterprise may be represented in its

investments. Again, in the case of the industrial mortgage institutes the duration of the loan and the period of amortisation are sufficiently shorter than the same with agricultural banks. The percentage of the estimated value of the property up to which a loan can be advanced is also fixed on a more conservative basis. Taking all these things into consideration, we are inclined to think that an Industrial Mortgage Bank is not much less secure than an agricultural mortgage institution. The recent experiment with industrial mortgage banking that has been made in Saxony, Finland and Hungary has been attended with considerable success and clearly demonstrates that such a type of institution is not only safe but is also a financial mechanism of considerable utility. Losses on mortgage loans made by the banks in every case have been either nil or insignificant ; while the borrowing industrial enterprises have been highly benefited.

There is a permanent need of this type of loan. Even in Europe where the capital market is highly organized and capital is neither shy nor unavailable, industries of a certain size or of a certain type, though perfectly sound, have met with great difficulties in obtaining their necessary long-term finances. In much poorer countries as in India, where capital is proverbially shy and the market for it unorganized or non-existent, industrial undertakings have to face yet greater difficulties in securing their capital and in a great many cases have to be kept back for want of it. Industrial mortgage banks are designed to satisfy this need which is always present in our economic society.

From the point of view of the investor, the mortgage bond, it should be observed, is under normal conditions, one of the safest classes of securities. The legal supervision, the dual security, general and specific, and the fact that the investor has the first lien on assets and earnings have made it more secure than the industrial debenture and often more safe than the bonds of the average central or local Government. The prior rights of debenture-holders are not always easily realizable. There are many recent instances where industrial companies fall-

ing on evil days have compelled them to give up their prior rights. As regards Government bonds, Government cannot be sued in law courts and in extreme cases may even repudiate. There is in India a large body of investors who consider safety first and will be content with a moderate return from an absolutely safe investment. To them the bonds of the proposed industrial mortgage bank should prove to be particularly attractive. In our scheme the security of the bonds is unquestioned and unchallengeable. There are no doubt some investors who would like some capital appreciation. Such investors generally believe that investment in bonds does not offer any opportunity for capital appreciation as that in shares. But this is really not the case. Owing to a multitude of factors, political and economic, the credit position of a bond may improve and its price may rise. To such investors, therefore, who desire some capital appreciation, the mortgage bonds should not also fail to appeal. We are firmly convinced that if the investing public could once be shown the advantages of investing in mortgage bonds, there would be no lack of investors in India. Bonds could be issued in different denominations and having different dates of maturity to suit different classes of investors. To invest in the bonds of a well-known mortgage bank, the investor would not require any high standard of knowledge; he could do so himself with confidence.

The establishment of a Specialist Institution for financing industries in India has been resisted by non-Indian opinion on the alleged ground that attempts at specialised industrial banking were made in the past and the experiment had definitely failed.[1] A large number of institutions sprang up, no doubt, during the post-war years in every part of India, styling themselves as "Industrial Banks." But as already pointed out, they could have no claim to that title. None of them were well-equipped, well-managed or conceived on truly scientific lines.

[1] Letter from the Chairman, Exchange Banks Association, Indian Central Banking Enquiry Committee, Vol. II, p. 625.

The basic principles of industrial financing were neither known nor understood. Even the Tata Industrial Bank which attracted considerable attention and was taken as a model by the Industrial Commission was not an exception.[1] The organisation that we have suggested here has no resemblance to these so-called "industrial banks" of the past; and it is not only theoretically sound but is also of considerable practical utility.

[1] See Chapter V, *supra*.

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